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# City of Bainbridge Island

## Transfer of Development Rights and Inclusionary Zoning Assessment

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February 2019

Prepared for:

City of Bainbridge Island

**FINAL REPORT**

**ECONorthwest**  
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# Executive Summary

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The City of Bainbridge Island is evaluating its affordable housing and transfer of development rights (TDR) incentive programs to understand how they can be better utilized to support citywide efforts to increase the amount of affordable housing and land maintained for open space, respectively. While these incentive programs have been in place for over 20 years, neither of these specific programs have been used much to-date; the current affordable housing program has been used once since 2005. The lack of use indicates that the current density bonus mechanism needs to be revised. To improve program utilization and support the realization of Bainbridge Island's broader comprehensive plan goals, the City Council requested an analysis of what incentives and zoning changes would be required make the City's affordable housing incentive program and TDR program work. In addition, the Council would like to understand the implications of a mandatory versus voluntary affordable housing program.

## Improving Market Conditions but Development Still Has Challenges

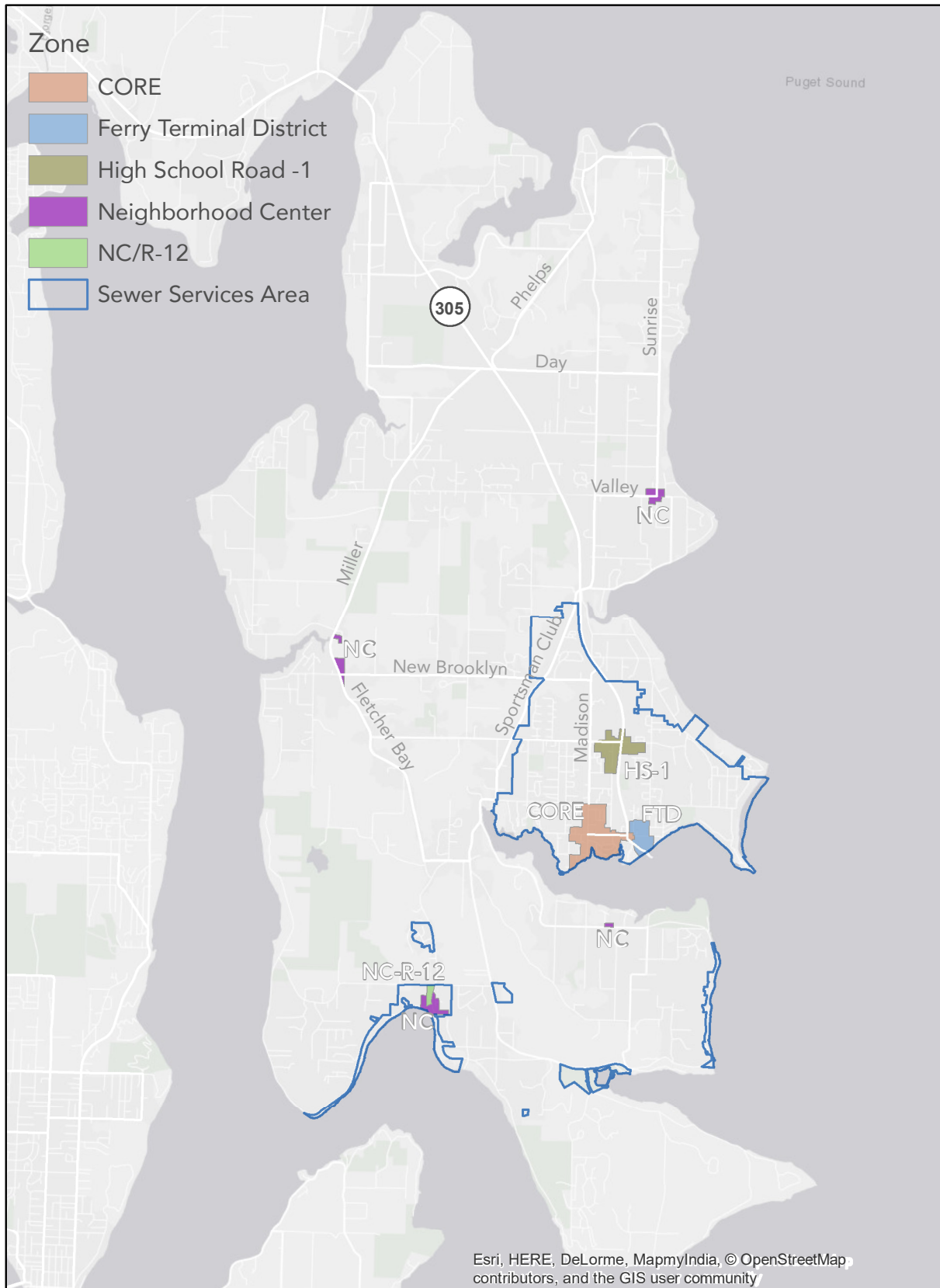
Bainbridge Island has realized increasing growth and stronger market fundamentals, particularly during the last five years. Apartment vacancies have declined, and average rents have increased. The median sales price for a home in Bainbridge Island has also increased from \$719,000 in 2009 and reached \$820,000 in 2018. In response to improving market conditions, building permit activity and the number of housing units built has increased over the last seven to eight years.

However, the number of housing units built during the last several years is still below the pre-2008 recession averages. In addition, increasing construction costs and land prices make the current market more challenging for new development to "pencil out."

## Development Code Presents Challenges for New Growth

ECONorthwest and Forterra evaluated the current incentive programs and analyzed the viability of multifamily and mixed-use buildings under the base zoning requirements and current bonus density incentives. This analysis focused on zones in the City's designated growth centers (Neighborhood Center, High School Road District, Ferry Terminal Overlay, and Central Core Overlay zones). Exhibit 1 shows where these zones are located within the city.

## Exhibit 1. Zones Analyzed



Source: City of Bainbridge Island, ECONorthwest

Overall, the development analysis found that current base zoning and available incentives do not support the provision of affordable housing units or purchase of TDR credits. While the current density bonus incentives do increase the value of each of the building types analyzed, they do not create enough value to capture for public benefits (e.g. affordable housing and land conservation). Further, the price for property in Bainbridge Island is relatively high due to the scarcity of infrastructure and limited number of developable sites in the City's designated (or growth) centers.

## Zoning Changes are Necessary to Incentivize Affordable Housing and TDR Use

To improve financial feasibility and utilization of the incentive programs, development projects need to be able to use development sites more efficiently and achieve more physical scale. To do this, the City has three key regulatory levers it can adjust.

- **Increasing density limits.** This would increase the amount of building square feet, primarily through higher floor area ratios (FAR) limits or more dwelling units per acre.
- **Raise height limits.** This would allow more building square feet and more flexibility developing a site to provide open space on the site.
- **Reduced parking requirements.** This helps reduce construction costs and allows more flexibility in developing a site.

These options align with the recommendations outlined in the Affordable Housing Task Force Final Report. The report recommends the City make code changes to increase density limits, building heights, and reduce parking requirements (Recommendation 1B).

## Strategic Options for Incorporating Public Benefits

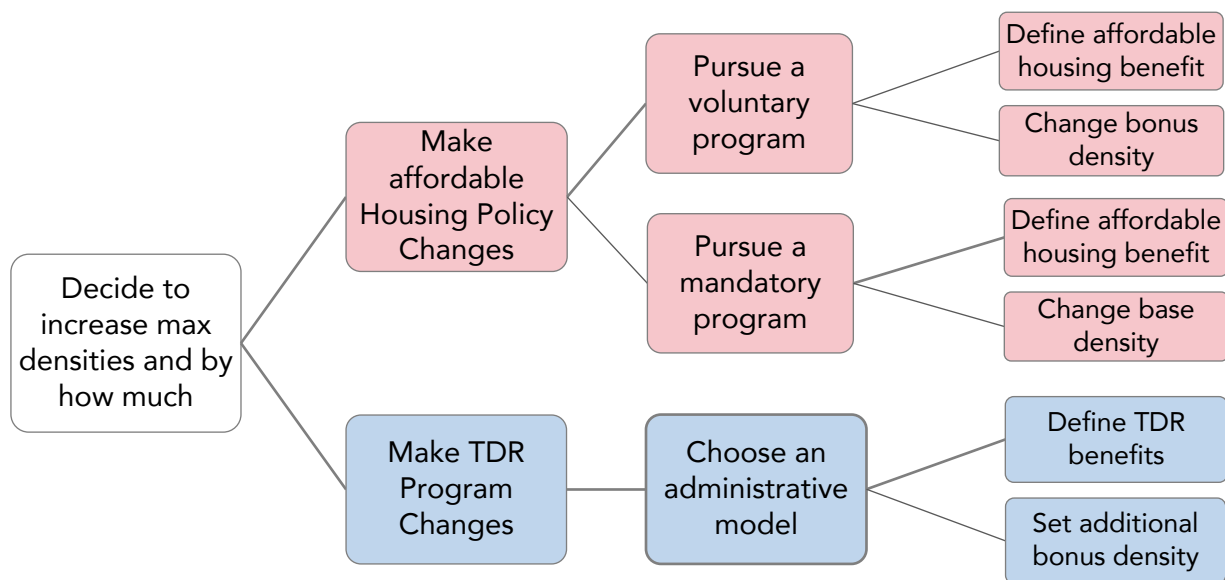
In addition to making the zoning changes described above, the City has several options to increase the provision of affordable housing units and/or purchase of TDR credits through how it defines the public benefits required to realize the incentives offered. The current TDR and affordable housing incentives function as separate programs. The City can continue to have them function separately and make changes to each so they work on their own. However, if desired, the City can link the programs so that both the provision of affordable housing and the purchase of TDR credits are realized from an individual project using the density bonus.

Exhibit 2 outlines the decision tree for making these policy decisions. For the affordable housing incentive program, an important, initial step is whether the City makes provisions for affordable housing voluntary or mandatory. The City currently has a voluntary program for affordable housing. However, the Affordable Housing Task Force Report recommended a mandatory program, pending the completion of this study (Recommendation 1A). For the TDR program, an initial step will be to define how the program is administered.

Subsequent steps will need to define the public benefit for affordable housing and TDR purchases required. The amount of affordable housing provided or TDR credits purchased

determine what level of density is needed to support the provision of those public benefits<sup>1</sup>. For example, a higher share of affordable units—10 percent compared to 5 percent—will require a higher level of density allowed so that projects are financially viable and get built. Thus, the base and bonus density limits for each approach will also differ.

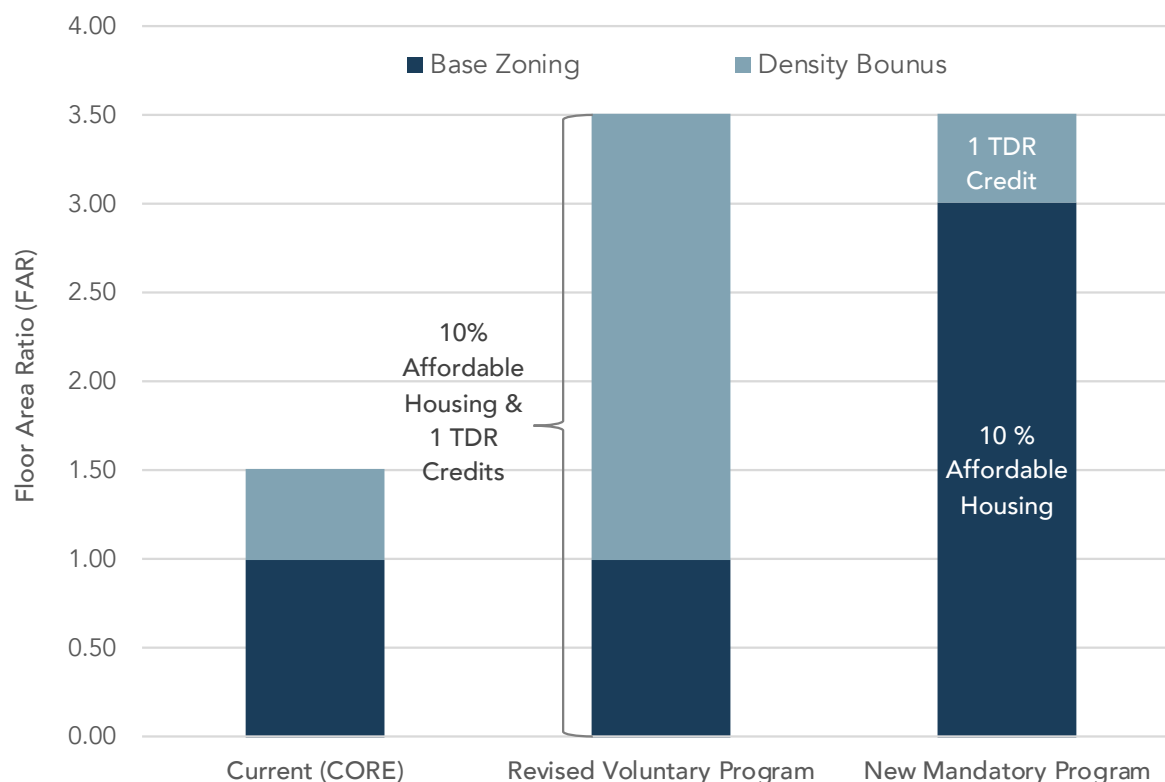
**Exhibit 2. Strategic Options Decision Tree**



The chart below shows the current FAR limits for a mixed-use building in the Central Core Overlay zone and how FAR limits would likely need to change under a revised voluntary or new mandatory program. The number of affordable units built, and TDR credits purchased would be different for mandatory program versus a voluntary program, even if the maximum density allowed is the same (e.g. 3.5 FAR).

<sup>1</sup> RCW 36.70A.540

**Exhibit 3. Example FAR Limits for Mixed-Use Building in the Central Core Overlay Zone**



Source: ECONorthwest

**Voluntary Program.** A revised version of this program would keep the base zoning the same and increase the density bonus (higher FAR limits and increased height). The value created through the increased density bonus can be divided between affordable housing and TDR purchases (50/50, for example). For our analysis, we assumed a development would make 10 percent of all units affordable and purchase at least one development right (or TDR credit) to realize the density bonus.

**Mandatory Program.** A mandatory program would be more complicated. All development projects would be required to provide a defined share of affordable housing units. Although, small scale project can be exempted from the requirement. To ensure projects are financially viable (so units get built) the City would need to substantially increase the base zoning density and height limits. Even if the defined share of affordable housing was the same as the voluntary program (10 percent), the total number of affordable units provided would be slightly less because the size of the building area that 10 percent applies to is smaller (a building area with 3.0 FAR compared to 3.5 FAR). A more detailed discussion is provided in Section 5.

In addition, a TDR incentive (additional density or height increase above the newly increased base zoning) would be added to the mandatory affordable housing requirement to provide a mechanism for TDR credits to be purchased.

## Other Tools, such as MFTE, can Support Incentive Programs

The City has a variety of other incentives it can use to ensure development feasibility as part of an incentive program in addition to increasing zoning capacity. Direct subsidies, tax abatements, and reduced parking requirements, which was mentioned above, are the most impactful. The Multi-Family Tax Exemption (MFTE) program<sup>2</sup> is the one of the best options in Washington State that is available to the City. The Affordable Housing Task Force also recommended the City adopt an MFTE program (Recommendations 1C).

The MFTE is a property tax abatement on the residential portion of new multifamily housing development. There are two versions of the program: an eight-year abatement and a 12-year abatement. The 12-year abatement requires that at least 20 percent of the housing units are affordable to households earning 80 percent of the Area Median Income. The eight-year program does not have an affordability requirement, but it can be used in conjunction with an affordable housing incentive zoning program.

The Development Analysis evaluated the eight-year version of the MFTE and found that it added substantial value to projects. Thus, not including an MFTE as part of the City's incentive program would likely require increasing allowed densities to compensate for the lost value and/or reducing the public benefits required to maintain the feasibility of projects.

## Trade-off Between Incentive Maximums and Public Benefits

The central question of this analysis is whether additional zoning capacity creates enough value to cover the additional cost of construction and operations and still provide a defined percent of affordable units and purchase TDR credits. If additional zoning capacity does create enough value, what are the FAR and height maximums necessary for the incentive program to work under current market conditions and future market changes.

To assess what scale and density are needed, ECONorthwest analyzed the same building prototypes and zones as in the baseline development analysis. This analysis assumed more building area and higher heights than currently allow under zoning. The analysis also assumed the City implemented an MFTE program and reduced parking requirements, as discussed in the sections above.

Exhibit 4 shows the maximum building scale and density assumed, the number of affordable housing units created (assuming 10 percent of units designated as affordable<sup>3</sup>), and the range of acres conserved (depending on the zoning of the sending site<sup>4</sup>).

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<sup>2</sup> RCW 84.14

<sup>3</sup> One-person household earning 80 percent of the area median income and spending 30 percent or less of their income on housing.

<sup>4</sup> Assuming an average value of \$75,000 per development right/credit.

#### Exhibit 4. Maximum Development Assumptions Evaluated by Zone and Estimated Benefits

	NC - Townhomes	NC/R-12 - Mixed Use	HS-1 - Multifamily	FERRY - Mixed Use	CORE - Mixed Use
Height	20	35	40	55	55
Density (Floor area ratio)	0.46	1.72	3.00	4.50	4.50
Density (Units per acre)	10.0	62.0	122.0	196.0	196.0
Parking (Spaces/Unit)	1.50	1.00	0.75	0.75	0.75
Affordable Units Created	1	6	6	18	9
Acres Conserved (High est.)	9.2	11.5	16.1	32.1	9.2
Acres Conserved (Low est.)	1.8	2.3	3.2	6.4	1.8

High estimate assume credits all purchased for land zoned R-0.4

Low estimate assume credits all purchased for land zoned R-2

Source: ECONorthwest

The development analysis results indicate the City would need allow for a substantial increase in floor area allowed for sizable provision of affordable housing and purchase of TDR credits under current market conditions. Current bonus FAR limits in the Mixed-Use Town Center and High School Road District are 1.0 and up to 1.5 in the Central Core Overlay zone. These limits would have to be increased to at least 3.0 in the High School Road District and 4.5 in the Mixed-Use Town Center. More modest increases in height (going from 45 to 55 feet) may also be necessary.

Ultimately, for any revisions to the current incentive program, there is a trade-off between different options that the City will need to consider. Allowing more density and heights will allow the City to require a higher share of affordable housing, lower affordability levels, and/or more dollars for purchasing TDR credits. Conversely, lower density and height maximums will result in less affordable housing and fewer dollars used for TDR purchases. However, if the defined public benefits are set too high, the private market might wait until market dynamics change for development to occur. This challenge is encountered by every jurisdiction trying to calibrate an incentive zoning policy.

### Considerations and Recommendations

The City's current affordable housing incentive program and TDR program are separate incentives that compete among several other incentives and FAR purchase options available within Bainbridge Island. Neither of these programs has been utilized as desired. Our analysis found the current base and incentive zoning parameters are the primary barrier to the incentives working effectively.

To improve performance and the realization of public benefits, we recommend an incentive zoning framework that 1) prioritizes affordable housing and the purchase of TDR credits above other public benefits (public spaces, underground parking, etc.), and 2) maximizes the frequency and period of time that these two incentives would likely be used under a variety of changing market conditions. Broadly, there are several key changes the City can undertake to better support these two objectives.

1. **Allow a new maximum height and FAR densities.** We recommend increasing the density and height of buildings within designated growth centers. While our analysis did not identify the current height limits as barrier to the utilization of the current incentive program, we recommend increasing the current limit to allow an additional floor, so the program provides flexibility to be used under changing market conditions in the future.

We also recommend moving to an FAR-based density limit for the NC zone. The zone currently uses units per acres to define density. An FAR-based density limit would be consistent with the other growth center zones and provide more flexibility.

The table below summarizes the recommended maximum density and height limits for density bonuses by zone. Our analysis only looked at five zones with these areas. Additional analysis would be needed to determine the bonus maximums for the zones not studied.

**Exhibit 5. Recommended Maximum Bonus Density and Height Limits**

Zone	Current Bonus Density	Current Bonus Height	Recommended Bonus Density	Recommended Bonus Height
Neighborhood Center	5 unit/ac	45 feet	0.5 FAR	45 feet
Neighborhood Center/R-12	12 units/ac	45 feet	2.0 FAR	45 feet
High School Road District – 1	0.6 FAR	45 feet	3.0 FAR	45 feet
Ferry Terminal Overlay	1.1 FAR	45 feet	4.5 FAR	55-75 feet
Central Core	1.0 FAR	45 feet	4.5 FAR	55-75 feet

Source: ECONorthwest

#### *Key Questions:*

*What areas of the city do you want to target for the affordable housing and/or the TDR program?*

*In what areas, if any, do you want both TDR and affordable housing to operate?*

*What zones do you want to increase capacity?*

2. **Reduce the other incentives available and focus on affordable housing and TDR.** The City currently offers incentives for several other public benefits including: providing underground parking, FAR purchases, providing on-site open space, tree preservation, historic structure preservation, etc.). Reducing competing options will prioritize the use of incentives for the affordable housing and TDR programs.
3. **Create an administrative model for the TDR program.** The current TDR program code does not identify a clear process by which a landowner or a developer can participate in the program. We recommend that the City creates both an administrative structure for the operation of the program as well as easily accessible informational resources to prospective users of the program. Until a robust market for TDR evolves in the City, we recommend a simple private buyer-seller model with public support. As program activity increases or if the City allocates funding to acquire TDR credits, the creation of a

TDR bank would serve a useful purpose to augment the private market transactions. Additional resources will support the emergence of a marketplace, such as an online listing of landowners who wish to sell their development rights, electronic copies of application forms that users can download, and a dedicated webpage for the TDR program that explains the tool, identifies sending and receiving areas, illustrates the process for using the program, and gives appropriate City staff contact information.

*Key Question: What type of administrative model does the City want to use?*

4. **Establish a fee in-lieu option for the affordable housing and TDR incentive programs.**

A fee in-lieu options would provide more flexibility for developments, particularly smaller projects. For example, as part of a revised TDR program the City could collect and use these funds for the purchase of development rights and conservation easements in Bainbridge Island.

*Key Questions:*

*Should the TDR program have a fee in-lieu option?*

*Should the affordable housing incentive have a fee in-lieu option?*

*Should there be a minimum size threshold for projects eligible for a fee in-lieu option?*

5. **Decide to maintain a voluntary or establish a new mandatory affordable housing program.** We recommend maintaining a voluntary affordable housing incentive program. The base zoning density limits are relatively low. Thus, most future projects will likely take advantage of the affordable housing incentive if calibrated correctly. As shown in Exhibit 3, a voluntary program has the potential to yield more public benefits when used compared to a mandatory program as well.

**Establish an MFTE program.** We recommend an 8-year MFTE program. Our analysis showed that the MFTE added value for multifamily developments and it would be an additional incentive to support the viability of multifamily projects and the use of incentive programs. In addition, an 8-year program allow the City to set its own affordability requirements (both the share of affordable units and length of affordability). The 12-year MFTE program requires 20 percent of units are affordable for 12 years.

*Key Questions:*

*Do you want to use the 8-year MFTE to further incentivize TDR placement?*

*Do you want the MFTE to supplement affordable housing production? If so, do you want to use an 8- or 12-year program?*

**6. Define the affordable housing and TDR benefits based on the new bonus density limits and other incentives.**

- For affordable housing we recommend 10 percent set aside of all units built. Our analysis indicated that this share would be viable at the densities modeled. The City currently requires that all units built through the density bonus be affordable. Because the base zoning limits are relatively low, a high percent of all units are affordable, which had a sizable effect on financial feasibility.
- For TDR, the benefit to a developer is defined by an exchange rate: what additional value does a developer gain by purchasing one credit? No exchange rate is currently set by the program or code and this uncertainty deters participation. If the City is going to award density bonus on an FAR basis, the appropriate units to express an exchange rate is in additional square feet of building area per credit purchased. For example, for each TDR credit purchased, a developer may build an additional 2,000 square feet of floor area up to the FAR limit of 3.5. Further evaluation of conservation area land values is needed to calibrate an exchange rate that will drive demand for TDR.

In addition to the seven changes above, there are several small, less critical changes the City can pursue that also will help support the affordable housing and TDR incentive programs that we also recommend the City consider.

- Expand the receiving areas available for TDR credits. Residential zones, such as R-2.9 and R-3.5 could support the placement of TDR credits and conservation open space elsewhere on the island by allowing additional units in exchange for purchasing a TDR credit.
- Remove separate FAR limits for residential and commercial uses in mixed-use buildings. Instead, establish one, new FAR limit for the entire building by zone as discussed above.
- Reduce parking requirements to 1.0 space per unit. Maintain reduction of half for areas within 0.5 mile of ferry terminal, which would then allow 0.5 space per unit within 0.5 mile of ferry terminal.
- Expand the areas where denser development can be built to increase the number lower cost development sites available where projects would be financially viable. In addition to rezoning areas, this would include ensuring existing neighborhood centers have the infrastructure available to support the growth planned for those areas.

# 1 Introduction

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The City of Bainbridge Island is evaluating its affordable housing and transfer of development rights (TDR) incentive programs to understand how they can be better utilized to support citywide efforts to increase the amount of affordable housing and land maintained for open space, respectively. Both programs are intended to incentivize development projects to include housing units that are more affordable, or to purchase development rights from areas elsewhere on the island to be maintained as open space (i.e. the transfer of a parcel's development right to a different location where growth is more desired). The incentive currently offered is a density bonus, which allows buildings to be larger and taller than allowed under the base zoning requirements.

Development incentive programs are complex and must be responsive to a constantly changing real estate market. The purpose of this study is to understand the real estate market conditions, evaluate the City's existing incentive provisions, and to recommend potential changes to the existing provision based on thorough analysis of different policy options and development feasibility.

The City Council has specifically stated an interest in understanding the potential of the current incentive programs to provide "workforce" housing (units affordable to households earning 60-80% of the median income) and to utilize transfer of development rights (TDR) credits. The Council also stated their interest in focusing on growth centers, including Neighborhood Centers and the Winslow Village area (High School Road district and zones near the ferry terminal with mixed-use zone and allowing greater densities). Overall, the Council wanted the analysis to assess what incentives and zoning changes would be required to make the City's incentive programs work and to understand the implications of a mandatory versus voluntary affordable housing requirement.

Key study questions:

- What is the current opportunity to use the land use code to achieve public benefits (e.g. affordable housing and land conservation)?
- What code changes limit or could support public benefit desires?
- Should the affordable housing provisions be voluntary through an incentive or mandatory?
- What other incentives could be used to support public benefit desires?

## 1.1 Previous Efforts

### Transfer of Development Rights

In 2006 a consultant team undertook a comprehensive review of the city's TDR program.<sup>5</sup> The evaluation included assessments of conservation priorities, market demand, credit valuation, program mechanics, and administration. Among the key findings from that report, several issues are unresolved and remain relevant to the current analysis. These include:

- **Demand for development rights is limited by receiving area capacity.** As a market-based real estate tool, TDR works when it is connected to demand for growth. Now, as then, opportunities for using TDR are constrained by a lack of places in which developers can gain additional value for projects by purchasing development rights.
- **Competing city programs further limit demand.** One ongoing challenge to the success of TDR is that developers have a range of options for achieving the desired intensities of projects. By streamlining these choices and aligning them with policy priorities the city can improve the chances of successfully achieving growth and conservation objectives.
- **The value of development rights in the receiving areas can vary considerably.** Since 2006, growth patterns across Bainbridge Island have continued to take a variety of forms. Different development types take a range of values and incentives that are attractive for one type but may not be feasible for others. This analysis takes such variability into consideration, whether considering TDR in the context of single-family development or multifamily, mixed-use projects in the downtown core.

The findings and recommendations of the 2006 report informed the design of the current analysis to the extent that some of the factors influencing TDR use then are still present. In the intervening time the dynamics of the local real estate market have shifted and policy priorities have evolved to include a greater emphasis on housing affordability. The present design challenges seek to balance market-based conservation, encouraging growth in specific areas and increasing the stock of affordable housing—either by mandate or through incentives.

### Affordable Housing

At the end of 2018 the City's Affordable Housing Task Force released its final report and recommendations. The City Council formed the Task Force to study and make recommendations about near-term actions the City can take to "improve access to affordable housing across the economic spectrum."<sup>6</sup> The Task Force was composed of 15 citizens who met over the next year and a half.

The Task Force's final report outlined five priority recommendations and five "Quick Wins" the City could pursue to address its affordable housing challenges. The five-priority recommendation included:

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<sup>5</sup> [City of Bainbridge Island Transfer of Development Rights Program Review](#), MAKERS and Community Attributes, 2006

<sup>6</sup> 2018 Affordable Housing Task Force Final Report, page 1

1. Draft and adopt code changes to encourage infill in the Designated Centers, with the assistance and advice of ECONorthwest.
2. Pursue opportunities to partner with the private and nonprofit sectors to build affordable housing on public lands.
3. Adopt procedures to encourage Accessory Dwelling Units.
4. Adopt an “Innovations Program” that allows staff to permit experimental affordable housing projects, on a limited basis, that are not currently allowed by code.
5. Create a permanent affordable housing committee and designate a City employee who will spend at least half-time on affordable housing strategies.

Recommendation number one directly relates the findings of this report. This recommendation also had three specific and related recommendations cited in the Task Force’s report.

- 1a. Adopt a Mandatory Inclusionary Zoning Ordinance
- 1b. Enact changes in FAR to encourage affordable housing
- 1c. Adopt a Multifamily Property Tax Exemption

The consultant team evaluated each of these specific recommendations in our analysis and address them later in the report.

## 1.2 Report Organization

The remainder of the report is organized in to four subsequent sections.

- **Policy Context.** This section summarizes the City’s growth policies with a focus on those most relevant to the TDR program and affordable housing incentives.
- **Existing Conditions.** This section reviews the incentive programs utilization, broad real estate market conditions, and the development feasibility of example projects under different zoning standards.
- **Policy Options.** This section assesses the City options for revising its affordable housing and TDR incentive programs.
- **Considerations and Recommendations.** The last section outlines the consultant team’s recommendations for moving forward and specific issues the City will likely have to make decisions about if it chooses to revise the incentive programs.

In addition, there are two appendices providing more detailed information on real estate market conditions (Appendix A) and the assumptions used in the development analysis (Appendix B).

## 2 Policy Context

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This section summarizes the City’s growth policies with a focus on those most relevant for affordable housing incentives and the TDR program. The City’s growth strategy—embodied in its comprehensive plan—is to concentrate growth in designated centers, which include Winslow, Lynwood Center, Rolling Bay, and Island Center. The types of housing and commercial uses prioritized through comprehensive plan policies in these areas include mixed-use development, small to mid-size single-family housing units, multifamily, tiny houses, accessory dwelling units, and cottage housing. The City has yet to adopt code enabling all of these housing types, however. These areas also have or are planned to have the infrastructure to accommodate growth. Winslow specifically is intended to have denser residential and commercial development, as it is located near the ferry terminal and is the city center. The other designated centers are intended to offer housing and small-scale commercial uses and services outside of Winslow.

The lands outside of the City’s designated centers are conservation areas, which minimize the impact of the built environment and protect aquifers, surface waters, and fish and wildlife habitat. Many of the City’s conservation priorities are driven by the desire to protect the island’s drinking water and aquifer system. Infrastructure and access to utilities also inform much of where Bainbridge Island directs growth.

The City has undertaken policies and actions to support resource conservation on the island.

- The TDR program establishes all properties located outside of designated centers, i.e. conservation areas, as development rights sending areas.<sup>7</sup> The current TDR program also permits agricultural land to be designated as a sending area through sale or transfer of development rights (at a higher rate), as well as allows property owners to donate all or a portion of their development rights to the city.
- The City updated its Critical Areas Ordinance earlier this year to better address priorities identified in the Comprehensive Plan and recommendations provided by the Washington Department of Fish and Wildlife.
- The City prepared an open space plan in 2008, which focused on identifying priority open space lands based on biodiversity values, ecological integrity, recreation, and historical/cultural values. Many of the higher-ranked priority lands are those adjacent to existing open spaces and dedicated parks, providing connected, high-quality habitats and working lands.
- The City also emphasizes the importance of protecting conservation areas through the public acquisition of certain properties, and tools such as aquifer recharge area regulations and promotion of smaller dwelling units to minimize development footprints.

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<sup>7</sup> Bainbridge Island Municipal Code (BIMC) Chapter 18.27.020 *Development Rights Sending Areas*.

## 2.1 Zoning Summary

The City's zoning code is one of the primary methods for implementing the City's growth strategy, and development incentives are a zoning-based tool. The City has a range of development incentives to support open space, affordable housing, the Purchase of Development Rights (PDRs), provision of public infrastructure, ferry parking, and the preservation of heritage trees and historic structures. Mixed use development is also encouraged in the Mixed Use Town Center zones through a higher FAR limit than for buildings with single uses.

As a tool for achieving the City's growth strategy, these incentives encourage growth in areas identified as Designated Centers to leverage desired community benefits. The incentives relevant to this study are those for the TDR program and affordable housing. Exhibit 6 lists the base density and height limits for select zones within Designated Centers and the bonus density limits for those zones.

**Exhibit 6. Current Base and Bonus Zoning Standards by Select Zone**

Zone	Base				Bonus			
		Residential	Mixed Use			Residential	Mixed Use	
	Units/Acre	FAR	FAR	Height (Ft)	Units/Acre	FAR	FAR	Height (Ft)
NC*	2.0	NA	NA	35	5.0	NA	NA	45
NC/R-12**	5.0	NA	NA	35	12.0	NA	NA	45
High School Road Districts	NA	0.3	0.3	35	NA	0.6	1.0	45
Ferry Terminal Overlay	NA	0.4	0.5	35	NA	1.1	1.3	45
Central Core Overlay	NA	0.4	1.0	35	NA	1.0	1.5	45

\*Infrastructure available

\*\*Mixed use building

Source: City of Bainbridge Island

### Incentives for Using the TDR Program

For the TDR Program, existing receiving sites for development credits include Winslow, High School Road, and other neighborhood centers.

- **Neighborhood Centers.** In the neighborhood centers, incentives focus on additional density, providing an additional one to two units per acre with use of TDR and public sewer and water.<sup>8</sup>
- **Winslow and High School Road Districts.** These areas are eligible for density increases (via a higher FAR) up to the maximum residential bonus limit through purchasing development rights.

<sup>8</sup> BIMC 18.12.030.D Bonus Density in NC District.

## Incentives for Providing Affordable Housing

The City currently has multiple incentive provisions in place to increase the production of affordable rental or for-sale housing units. All the affordable housing related incentive programs are voluntary, and the mechanisms and bonuses allowed depend on the specific zone.

- **Residential Density Bonus Provisions.** The City allows increased density (through more units or floor area) above the base requirements with the provision of affordable housing units.
  - Residential Zones: Residential subdivisions in residential zones can receive a density bonus<sup>9</sup> (one additional unit per acre) for every affordable unit provided above the base density requirements. Housing developments can receive density increases up to 50 percent above the base limit. All additional (or bonus) units must be affordable to households at or below the defined low-income threshold (51-80 percent of area median income, or AMI).
  - Neighborhood Centers: Projects within designated Neighborhood Centers can receive a density bonus of an additional one to two units per acre by providing affordable housing for low income households (51-80 percent of AMI).
  - Winslow Mixed-Use and High School Road Districts: Projects within either of these two districts may receive bonus floor area above the base Floor Area Ratio (FAR) up to the maximum FAR limit for additional floor area dedicated to affordable housing units. The level and mix of affordability depend on the overall size of the project. Projects less 10,000 square feet have to provide units affordable to at least moderate-income households (81-95 percent of AMI). Larger projects, those over 60,000 square feet, must provide at least 10 percent of the bonus area for at least low-income households 60 percent for moderate income households, and the remaining 30 percent of the bonus area for middle income households (96-120 percent of AMI).
- **Housing Design Demonstration Projects (HDDP).** The HDDP is an optional development process that provides more flexible design standards as well as density bonuses for residential housing projects that provide a diversity of unit sizes, meet green building standards, and incentivizes designated affordable units.

The program has four tiers of density incentives based on the level of green building and affordable housing provisions met. Projects qualifying for Tier 1 do not receive any density bonus, while Tiers 3 4 projects can receive a bonus of up to 2.5 times the base density or the maximum FAR allowed.

Single-family subdivisions and multifamily developments (including mixed-use buildings) within the Winslow Study Area of the Winslow Master Plan and Winslow Sanitary Sewer System Service Area are eligible to participate in the program. To date, the program has produced 47 affordable housing units. Housing Resource Bainbridge constructed 40 of the units in the Ferncliff Village projects, and another seven units

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<sup>9</sup> BIMC 18.21

under construction in two separate development projects. In August 2018, the City Council suspended the HDDP program for projects that are not 100 percent affordable housing.

## 2.2 Transfer of Development Rights

The City's TDR program is defined in BMC 18.27 with a purpose of protecting wetlands, aquifer recharge areas, agricultural land, and open space while encouraging growth in higher density areas within the city.

Currently, the City's TDR program is designed to function through private market interactions. Many developers we interviewed for this report were unaware of the existence of the program and expressed interest in using it to achieve higher intensity uses in their projects. Unlike other TDR programs around the central Puget Sound region, the Bainbridge Island example does not have a dedicated informational web page to explain the program or direct prospective users in how to participate.

The current code defines two key components of the program, sending sites (those areas the City seeks to conserve) and receiving sites (those areas where the City encourages growth, or the areas to which development rights are transferred).

- **Sending Sites.** Currently, the entire island outside of designated centers is identified as a potential sending site (referred to as "conservation areas" in the comprehensive plan). As a result, all potential properties are assumed to have comparable conservation value.
- **Receiving Sites.** Sites eligible for using the TDR incentive program are located within Winslow Mixed use Town Center and High School Road Districts, NC Districts, and R-14 and R-8 districts.

The code also specifies that a conservation easement is the legal instrument by which the sending site will be protected. Landowners seeking to conserve their properties apply to the city for issuance of TDR certificates, which are calculated based on how many homes the landowner could build on the property. Once the landowner has accepted a conservation easement and deed restrictions have been recorded with the City and County, the City issues certificates which the landowner may in turn sell to developers who wish to add density to an eligible project in a receiving area.

The current program has practical limitations, including no clear definition of an exchange rate (how much bonus value does a developer gain from purchasing a credit), no standardized forms or process for applying to the program, and no sample easement language for sending site landowners. It also does not address stewardship and monitoring of protected areas. The lack of a fixed exchange rate introduces challenges for developers, as this reduces certainty in a transaction. Developers need to know how much value a credit will add to a project in order to understand how much money they can offer to buy one from a sending site landowner.

## 2.3 Affordable Housing

The Housing Element of the Comprehensive Plan establishes the housing goals and implementing policies for Bainbridge Island. The broader vision embodied in the Housing Element is for a city with a broad variety unit types, primarily in the designated growth centers. The City's affordable housing density bonus program is one of the tools for implementing this vision. Chapter 18.21 of the municipal code establish the affordable housing density bonus provisions. Affordability levels are based on the area median household income and households size. Appendix C shows the median income limits by household size used for 2018. The income categories are defined as follows:

- Extremely low income—less than 30 percent of median household income.
- Very low income—31 to 50 percent of median household income.
- Low income—51 to 80 percent of median household income.
- Moderate income—80 to 95 percent of median household income.
- Middle income—96 to 120 percent of median income.

The amount of the density bonus depends on the affordability level of the units provided and if the units are for-rent or for-sale. All additional units built above the base zoning limits must meet the following affordability requirements.

- **Rental units** can receive a bonus of 50 percent of the base zoning if the additional units provided are affordable for households in the low-income category or below.
- **For-sale units.** There are three tiers for the bonus area depending on the affordability levels of the additional units provided.
  - Bonus of 50 percent of the base zoning if the additional units provided are affordable for households in the low-income category or below.
  - Bonus of 40 percent of the base zoning if the additional units provided are affordable for households in the moderate-income category or below.
  - Bonus of 20 percent of the base zoning if the first 10 percent of the additional units provided are affordable for households in the moderate-income category and the remaining 10 percent are affordable to households in the middle-income category.

## 3 Existing Conditions

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Understanding the current real estate market conditions is critical to designing an effective development incentive program. This section summarizes the existing real estate market conditions affecting development in Bainbridge Island and City' incentive programs for affordable housing and TDR. Our analysis included both a market study and interviews with 12 local real estate professionals.

### 3.1 Program Utilization

The current incentive programs available for affordable housing and TDR have not been utilized as desired. Incentive zoning policies are intended to leverage new market-rate development for the production of public amenities. However, these policies can only work when new development is financially feasible. The structure of an incentive zoning program should make it economically attractive for developers to use the incentive under most market conditions.

The real estate market in Bainbridge Island has realized increasing growth and stronger market fundamentals, particularly during the last five years. However, other constraints have hindered the use of the City's affordable housing and TDR incentive program. Many of the limiting factors identified in the 2006 MAKERS/Community Attributes evaluation of the TDR program remain in place. Specific factors identified include the absence of a market mechanism and insufficient opportunities for demand to use the TDR credits. Furthermore, we learned in our conversations with developers that many are not even aware of the existence of the TDR program.

### 3.2 Real Estate Market Conditions

The real estate market trends and recent development examples point to a city that is seeing an increase in demand, primarily for housing development of all types. This uptick in demand has occurred relatively recently. For much of the 2010s, the city did not realize much new development following the effects of the recession in 2008. As a result, the housing supply has been lagging housing demand and rents and sales prices have been increasing, particularly over the last five years.

A continuation of these growth trends and historically low vacancies indicate there will likely be demand for more housing (single-family and multifamily) in the future. The resulting increase in population will also drive the demand for additional commercial space to provide goods and services.

For a development incentive program to be effective it needs to align with where development is occurring, the uses that are demanded, and the intensity of that development. Recent trends and market conditions in Bainbridge Island indicate there is an opportunity for the utilization of

development incentives. Appendix A includes a more detail summary of the market study. Key findings include:

- **Winslow Has the Most Potential for Future Development.** Winslow has realized much of the new growth in Bainbridge Island, which aligns with the City’s comprehensive plan. Winslow has the infrastructure, specifically water and sewer service, to accommodate future growth. Winslow is also an attractive location for development because of the proximity to the ferry terminal.
- **Neighborhood Centers have Limited Potential Due to a Lack of Infrastructure.** In the comprehensive plan, neighborhood centers are designated for more intense development. With the exception of Lynwood Center, a lack of infrastructure (primarily sewer service) limit the development potential of these areas. The capacity and use of development incentives within these areas will be tied to the provision of the necessary infrastructure.
- **Residential Uses Present the Best Opportunity for Utilizing Development Incentives.** Most of the recent development and permit activity in Bainbridge Island is for single-family housing. More recently, multifamily housing, particularly in Winslow, is also realizing sizable new developments. As a result, development incentives should focus on leveraging demand for these uses.
- **Residential Projects Will Want to Maximize Density.** Future projects may be looking to increase densities (i.e. smaller lots and more units per acre for single-family homes and more height and building area for multifamily projects). This demand can be leveraged to support both the purchase of development rights and the creation of affordable housing as part of a City’s development incentive programs.

### 3.3 Stakeholder Interviews

To supplement the market study, we interviewed 12 real estate professionals including developers, architects, affordable housing providers that work in Bainbridge Island. All of the stakeholders interviewed noted the increasing cost of housing in Bainbridge Island over the last several years. However, they also noted that increasing construction cost and land prices are making it more challenging for new projects to “pencil out.” Several common themes emerged from these interviews, which are summarized below.

- **Regulatory Barriers.** A number of interviewees expressed their wish for more flexibility in the zoning code, especially regarding density and height limitations. High minimum parking requirements was also noted as an issue in some zones (primarily those not by the Ferry Terminal).
- **Environmental Concerns.** Several interviewees expressed concerns about the environmental effects from increased development, primarily the loss of trees and open space. However, others thought the City prioritized environmental issues too much over housing affordability.

- **Limited Sewer, Sanitation, and Water Services.** All of the interviewees emphasized the limitations that the lack of sewer, sanitation, and water services imposed on development site designations outside of the Winslow core area, which limits the developable land available in the city.
- **Little familiarity with the TDR program.** In addition, we asked the interviewees about their knowledge of the City's transfer of development (TDR) program. Few people were familiar with the program even if they knew it existed. A majority of them revealed to possess little to no knowledge of this program.

When asked how they would recommend the City address these challenges, interviewees suggested that 1) more flexibility in the zoning codes, 2) reduced parking requirements especially for areas near the ferry terminal, 3) increased heights in the zoning code, 4) more incentives for open space, tree retention, and higher density development, 5) more sewer, water, and sanitation services outside of the Winslow core area, and 6) a better overall communication from the City Council on the island's growth plan.

## 4 Development Analysis

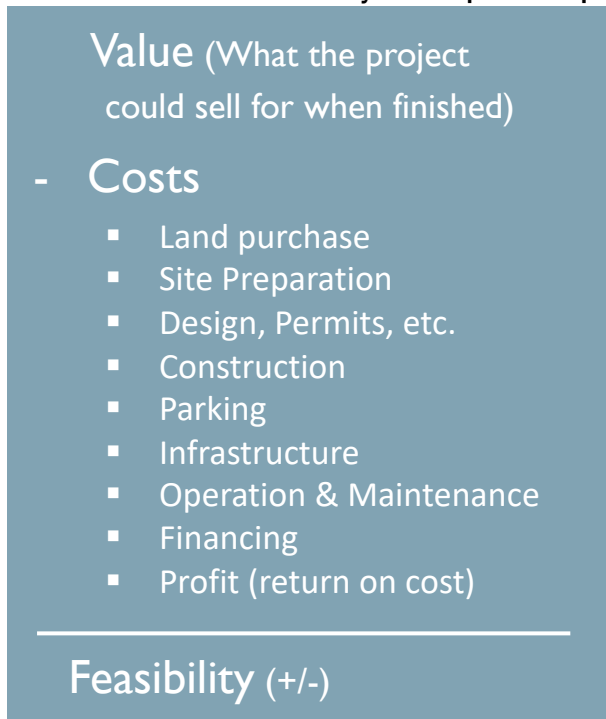
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The central question of a development analysis for an incentive zoning program is whether the incentive offered (typically additional development capacity) creates enough value to cover the additional cost of construction and operations in addition to the cost of providing the public benefit required as part of receiving the incentive. For affordable housing, the cost to a developer is foregone rental income. For land conservations, the cost to a developer is the dollars to purchase the development right(s). To evaluate this question, ECONorthwest conducted a financial analysis of different building types within select zones. The analysis evaluated the financial viability of these buildings under the current base and density bonus provisions and hypothetical larger density bonus provisions. This section provides an overview of the method and assumptions used and the finding of the development analysis

### 4.1 Approach

Development feasibility is based on the difference of the potential value of a development project, less the costs to build it. If the value of a hypothetical project is higher than the total cost, which includes the developers profit requirements, the project is likely feasible in the current market. Exhibit 7 depicts this development equation and its pieces.

**Exhibit 7. Financial Feasibility Development Equation**



Value (What the project could sell for when finished)

- Costs

- Land purchase
- Site Preparation
- Design, Permits, etc.
- Construction
- Parking
- Infrastructure
- Operation & Maintenance
- Financing
- Profit (return on cost)

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Feasibility (+/-)

To calculate the value and costs, ECONorthwest used a pro forma analysis. A pro forma analysis models all of the costs of constructing a new building—including design, permit fees, site improvements, any developer fee, and contingencies—to arrive at a total cost for each building prototype. The pro forma analysis then models potential revenues the new building

would generate based on how much rent a building would generate in a year or the price if it was sold. Lastly, the analysis then applies an assumed rate of return to account for the profit a developer would require.

It is also important to keep in mind that development feasibility depends on several factors in addition to the assumed revenues, costs, and returns. The feasibility of any site can also be dependent on the individual developer and other idiosyncratic factors, such as when a developer bought the property, their ability to finance a project, and their tolerance for risk. Thus, the pro forma analysis is a snapshot of feasibility under current market conditions and typical development assumptions.

## Key Financial Assumptions

The pro forma analysis used several key assumptions<sup>10</sup> to calculate financial feasibility. Appendix B lists the specific assumptions for each prototype.

- Apartment rent: \$2.50 per square foot per month (or equivalent of \$2,500 a month for a 1,000-square foot two-bedroom apartment).
- Retail rent: \$25.00 per square foot per year.
- Townhome sales price: \$450.00 per square foot.
- Residential wood-frame construction costs: \$180 per square foot.
- Commercial concrete podium costs: \$240 per square foot.
- Surface Parking: \$5,500 per space.
- Ground floor Parking: \$30,000 per space.
- Underground Parking: \$60,000 per space.
- Land cost for NC zone: \$25.00 per square foot.
- Land cost for Central Core and Ferry Terminal Overlay zones: \$75.00 per square foot.
- Land cost for High School Road District: \$60.00 per square foot.
- TDR credit cost: \$75,000 per development right.

## Building Types and Zones Analyzed

The feasibility analysis evaluates the financial performance of hypothetical developments in five different zones on Bainbridge Island (Neighborhood Center, Neighborhood Center/Residential-12, High School Road District 1, Ferry Terminal Overlay, and Central Core Overlay). These zones are areas designated as growth centers in the City's comprehensive plan, and the Council is interested in understanding what scale of development is currently feasible within these zones and what (if any) changes are needed to make the current incentives better utilized.

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<sup>10</sup> Sources: Rent based on local comparable developments and assumptions by ECONorthwest. Development costs based on discussions local builders, and returns assumption are from ECONorthwest.

Exhibit 8 compares the existing or current development standards for the base zoning and density bonus limits for zones included in the analysis.

**Exhibit 8. Current or Existing Development Standards of Zones Analyzed**

Zone	Base				Bonus			
	Units/Acre	Residential FAR	Mixed Use FAR	Height (Ft)	Units/Acre	Residential FAR	Mixed Use FAR	Height (Ft)
NC*	2.0	NA	NA	35	5.0	NA	NA	45
NC/R-12**	5.0	NA	NA	35	12.0	NA	NA	45
High School Road Districts	NA	0.3	0.3	35	NA	0.6	1.0	45
Ferry Terminal Overlay	NA	0.4	0.5	35	NA	1.1	1.3	45
Central Core Overlay	NA	0.4	1.0	35	NA	1.0	1.5	45


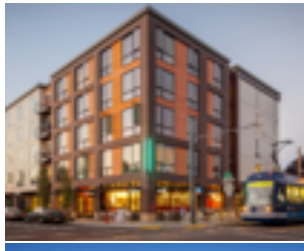


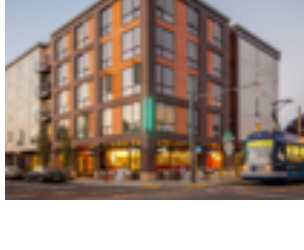
\*Infrastructure available

\*\*Mixed use building

Source: City of Bainbridge Island

Within these five zones, the development analysis evaluated the financial feasibility of a specific building type currently allowed within that zone. The analysis included three different building types: townhomes, garden apartments, and a residential mixed-use building. Exhibit 9 shows each building type analyzed for the corresponding zone.

## Exhibit 9. Building Types Analyzed

Zone	Building Type	
Neighborhood Center	<b>Townhome</b>	    
	Max Base Density: 2 units/acre	
	Max Bonus Density: 5 units/acre	
Neighborhood Center/R-12	<b>Mixed-Use Building</b>	
	Max Base Density: 5 units/acre	
	Max Bonus Density: 12 units/acre	
High School Road District – 1	<b>Garden Apartment</b>	
	Max Base Density: 0.3 FAR	
	Max Bonus Density: 0.6 FAR	
Ferry Terminal Overlay	<b>Mixed-Use Building</b>	
	Max Base Density: 0.5 FAR	
	Max Bonus Density: 1.3 FAR	
Central Core	<b>Mixed-Use Building</b>	
	Max Base Density: 1.0 FAR	
	Max Bonus Density: 1.5 FAR	

Source: ECONorthwest

## Scenarios Analyzed

To assess the effects of zoning and development incentives on financial feasibility and the ability to create value to support the provision of public benefits, ECONorthwest analyzed the feasibility of the building types above under three scenarios:

- **Base zoning.** Assumes the building meets the base zoning requirement (density, height, etc.).
- **Current density bonus.** Assumes the same building maximizes the density bonus density and height limits.

- **Increased density bonus.** Assumes higher density and height limits than currently allowed.

In addition to analyzing each building type under the base zoning and density bonus scenarios, the analysis also assumed a couple of additional development incentives along with the current density bonus. Specifically, the two incentives factored into the analysis include:

- **Multifamily Tax Exemption (MFTE).** An 8-year property tax property tax abatement on the residential portion of new multifamily housing development. There are no specific affordability requires for the 8-year version under state statutes.
- **Lower parking requirement.** Assumed minimum parking requirements are half of the current standards.

The analysis then compared the total value of each scenario for each of the five prototypes. As long as the value is positive (it exceeds the total costs including a developer's assumed return), it can be used to support the realization of public benefits such as affordable housing or purchase of TDR credits. However, in order to for the incentive to be a true incentive for developers, the developer must also receive a share of the additional value.

## 4.2 Feasibility Comparison

Overall, the development analysis found that current base zoning and available incentives will likely not support the dedication of public benefits for TDR or affordable housing. While the current incentives increase the value of each of the building types analyzed, they do not create enough value to capture public benefits for the City in the land use code (e.g. land conservation and affordable housing). Further, the price for property in Bainbridge Island is relatively high due to the scarcity of infrastructure and limited development sites. Vacant properties typically cost less than developed parcels and are more likely to be financially feasible to develop at similar market conditions. As a result, the building type analyzed are not financially viable (even with the current incentives) on more costly developed sites.

**Exhibit 10. Current Feasibility of Development by Zone**

Scenario	Base Zoning	Current Bonus	Current Bonus
		- TDR	- IZ
NC - Multifamily	No	Yes	No
HS-1 - Multifamily	No	No	No
FERRY - Mixed Use	No	No	No
CORE - Mixed Use	No	No	No

Source: ECONorthwest

To improve financial feasibility, development projects need more physical scale, primarily through increasing the amount of building square feet and potentially increased building heights. To assess what scale and density are needed, ECONorthwest analyzed the same building prototypes and zones as in the baseline development analysis. This analysis assumed more building area and higher heights than currently allow under zoning.

The analysis also assumed a few other key changes in zoning standards and incentive program requirements including:

- Parking requirements are lower than currently required,
- A new 8-year MFTE program is in place, and
- 10 percent of all unit built are affordable for a household of one earning at least 80 percent of the area median income (the equivalent of \$54,000 a year).

Exhibit 11 shows the densities and development conditions likely necessary for development projects to provide a sizable amount of affordable housing and conservation benefits under current market conditions. Specifically, the table shows the estimated number of affordable units created and acres of land conserved based for a single project within that zone. The high estimate of land conserved assumes the sending site is zoned R-0.4, and the low estimate for land conserved assumes the sending site is zoned R-2.

**Exhibit 11. Maximum Development Assumptions Evaluated by Zone and Estimated Benefits**

	NC - Townhomes	NC/R-12 - Mixed Use	HS-1 - Multifamily	FERRY - Mixed Use	CORE - Mixed Use
Height	20	35	40	55	55
Density (Floor area ratio)	0.46	1.72	3.00	4.50	4.50
Density (Units per acre)	10.0	62.0	122.0	196.0	196.0
Parking (Spaces/Unit)	1.50	1.00	0.75	0.75	0.75
Affordable Units Created	1	6	6	18	9
Acres Conserved (High est.)	9.2	11.5	16.1	32.1	9.2
Acres Conserved (Low est.)	1.8	2.3	3.2	6.4	1.8

High estimate assume credits all purchased for land zoned R-0.4

Low estimate assume credits all purchased for land zoned R-2

Source: ECONorthwest

## Development Analysis Summary

The development analysis found that current base zoning and available incentives will not support the provision of affordable housing units or purchase of TDR credits. While the current density bonus incentives do increase the value of each of the building types analyzed they do not create enough value to capture for public benefits (e.g. affordable housing and land conservation). Key findings include:

- Density limits are the primary impediment to development viability. To improve financial feasibility and utilization of the incentive programs, development projects need to be able to use development sites more efficiently and achieve more physical scale.
- Increasing maximum density creates a lot of value that can be used for subsidizing affordable housing and purchasing TDR credits.
- Lower parking requirements are also an important factor in how efficiently a building can use a site and the total cost of a project.

- Height limits are not an impediment to development under current market conditions. However, in the future under changing market conditions, an additional floor would allow more building square feet and more flexibility developing a site to provide open space on the site.

These findings align with the recommendations outlined in the Affordable Housing Task Force Final Report. The report recommends the City making code changes to increase density limits, building heights, and reduce parking requirements (Recommendation 1B).

## 5 Policy Options

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Setting efficient regulatory and performance parameters for incentive zoning programs is a challenging endeavor. The city must balance the desire to leverage private development to deliver public benefits against additional costs imposed on the project. This challenge is compounded by ever changing market conditions, such as changes in construction costs, cost of capital, household incomes, land prices, and rent—all of which affect the financial viability of a project over time.

To increase the realization of public benefits the development analysis determined the City will need to make changes to its existing incentive program. The City has several strategic options to optimize its zoning provisions and increase the potential for development and the realization of TDR purchases and/or affordable housing units. All options will require the City to allow a sizable increase in the density allowed to create enough value for projects to provide the public benefits desired and still be financially viable.

### Voluntary or Mandatory Affordable Housing Program

In addition to making the zoning changes described above, the City has several options to increase the provision of affordable housing units and/or purchase of TDR credits through how it defines the public benefits required to realize the incentives offered. The current TDR and affordable housing incentives function as separate programs. The City can continue to have them function separately and make changes to each so they work on their own. However, if desired, the City can link the programs so that both the provision of affordable housing and the purchase of TDR credits are realized from an individual project using the density bonus.

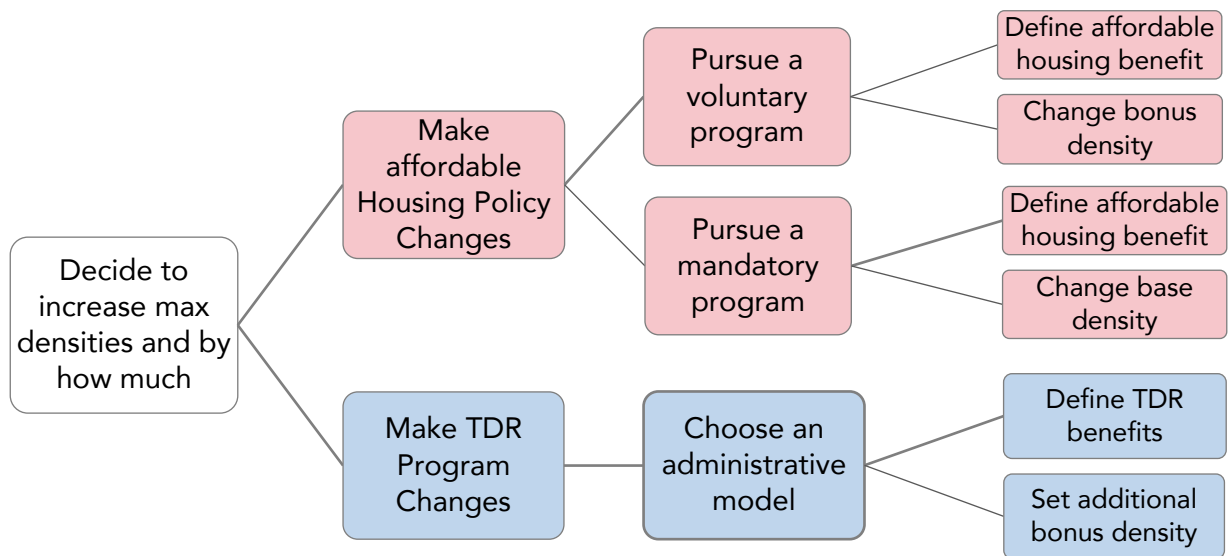
Exhibit 12 outlines the decision tree for making these policy decisions. For the affordable housing incentive program, an important, initial step is whether the City makes provisions for affordable housing voluntary or mandatory. The City currently has a voluntary program for affordable housing. However, the Affordable Housing Task Force Report recommended a mandatory program, pending the completion of this study (Recommendation 1A). For the TDR program, an initial step will be to define how the program is administered.

Subsequent steps will need to define the public benefit for affordable housing and TDR purchases required. The amount of affordable housing provided or TDR credits purchased determine what level of density is needed to support the provision of those public benefits<sup>11</sup>. For example, a higher share of affordable units—10 percent compared to 5 percent—will require a higher level of density allowed so that projects are financially viable and get built. Thus, the base and bonus density limits for each approach will also differ.

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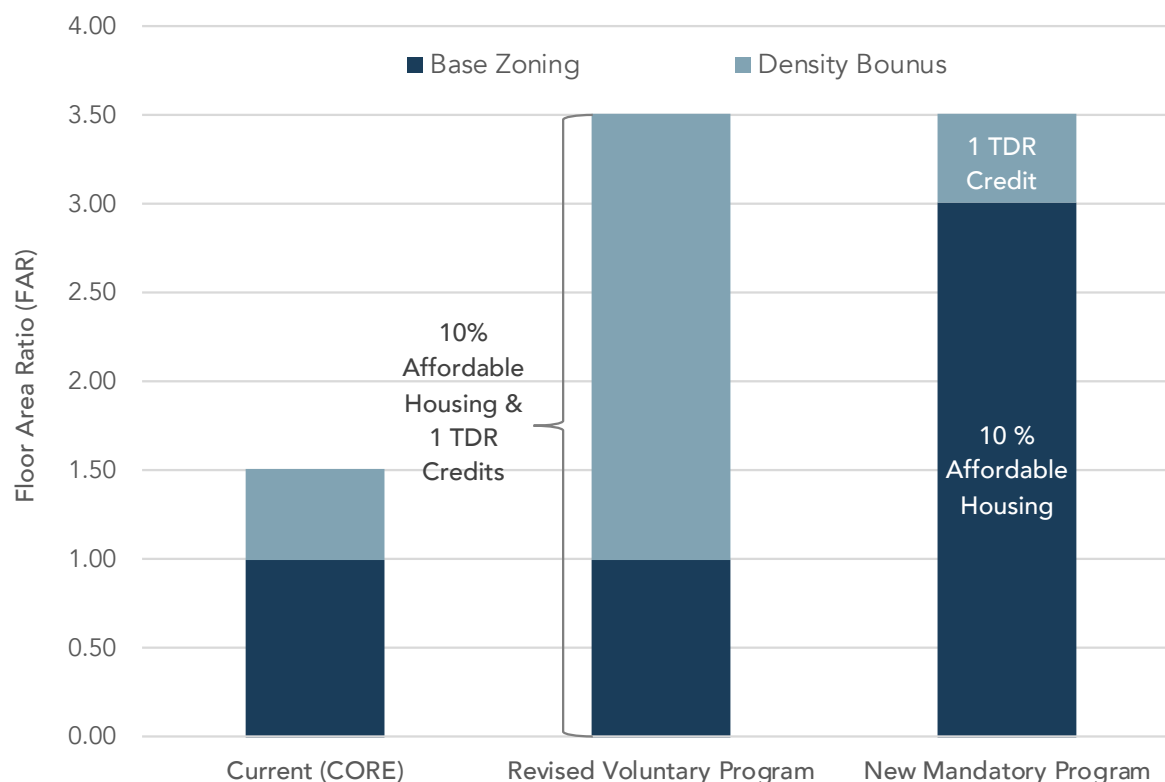
<sup>11</sup> RCW 36.70A.540

**Exhibit 12. Strategic Options Decision Tree**



The chart below shows the current FAR limits for a mixed use building in the Central Core Overlay zone and how FAR limits would likely need to change under a revised voluntary or new mandatory program. The number of affordable units built and TDR credits purchased would be different for mandatory program versus a voluntary program, even if the maximum density allowed is the same (e.g. 3.5 FAR).

**Exhibit 13. Example FAR Limits for Mixed-Use Building in the Central Core Overlay Zone**



Source: ECONorthwest

**Voluntary Program.** A revised version of this program would keep the base zoning the same and increase the density bonus (higher FAR limits and increased height). The value created through the increased density bonus can be divided between affordable housing and TDR purchases (50/50, for example). For our analysis, we assumed a development would make 10 percent of all units affordable and purchase at least one TDR credit to realize the density bonus.

**Mandatory Program.** A mandatory program would be more complicated. All development projects would be required to provide a defined share of affordable housing units. Although, small scale project can be exempted from the requirement. To ensure projects are financially viable (so units get built) the City would need to substantially increase the base zoning density and height limits. Even if the defined share of affordable housing was the same as the voluntary program (10 percent), the total number of affordable units provided would be slightly less because the size the building area that 10 percent applies to is smaller (a building area with 3.0 FAR compared to 3.5 FAR).

In addition, a TDR incentive (additional density or height increase above the newly increased base zoning) would be added to the mandatory affordable housing requirement to provide a mechanism for TDR credits to be purchased.

## Other Tools, such as MFTE, can Support Incentive Programs

The City has a variety of other incentives it can use to ensure development feasibility as part of an incentive program in addition to increasing zoning capacity. Direct subsidies, tax abatements, and reduced parking requirements, which was mentioned above, are the most impactful. The Multi Family Tax Exemption (MFTE) program<sup>12</sup> is the one of the best options in Washington State that is available to the City. The Affordable Housing Task Force also recommended the City adopt an MFTE program (Recommendations 1C).

The MFTE is a property tax abatement on the residential portion of new multifamily housing development. There are two versions of the program: an eight-year abatement and a 12-year abatement. The 12-year abatement requires that at least 20 percent of the housing units are affordable to households earning 80 percent of the Area Median Income. The 8-year program does not have an affordability requirement, but it can be used in conjunction with an affordable housing incentive zoning program.

The Development Analysis evaluated the eight-year version of the MFTE and found that it added substantial value to projects. Thus, not including an MFTE as part of the City's incentive program would likely require increasing densities allowed to compensate for the lost value and/or reducing the public benefits required to maintain the feasibility of projects.

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<sup>12</sup> RCW 84.14

## Trade-off Between Incentive Maximums and Public Benefits

The central question of this analysis is whether additional zoning capacity creates enough value to cover the additional cost of construction and operations and still provide a defined percent of affordable units and purchase TDR credits. If additional zoning capacity does create enough value, what are the FAR and height maximums necessary for the incentive program to work under current market conditions and future market changes.

To assess what scale and density are needed, ECONorthwest analyzed the same building prototypes and zones as in the baseline development analysis. This analysis assumed more building area and higher heights than currently allow under zoning. The analysis also assumed the City implemented an MFTE program and reduced parking requirements, as discussed in the sections above.

Exhibit 4 shows the maximum building scale and density assumed, the number of affordable housing units created (assuming 10 percent of units designated as affordable<sup>13</sup>), and the range of acres conserved (depending on the zoning of the sending site<sup>14</sup>).

**Exhibit 14. Maximum Development Assumptions Evaluated by Zone and Estimated Benefits**

	NC - Townhomes	NC/R-12 - Mixed Use	HS-1 - Multifamily	FERRY - Mixed Use	CORE - Mixed Use
Height	20	35	40	55	55
Density (Floor area ratio)	0.46	1.72	3.00	4.50	4.50
Density (Units per acre)	10.0	62.0	122.0	196.0	196.0
Parking (Spaces/Unit)	1.50	1.00	0.75	0.75	0.75
Affordable Units Created	1	6	6	18	9
Acres Conserved (High est.)	9.2	11.5	16.1	32.1	9.2
Acres Conserved (Low est.)	1.8	2.3	3.2	6.4	1.8

Source: ECONorthwest

The development analysis results indicate the City would need allow for a substantial increase in floor area allowed for sizable provision of affordable housing and purchase of TDR credits under current market conditions. Current maximum bonus FAR limits (for mixed use development) in the Mixed-Use Town Center and High School Road District are 1.0 and up to 1.5 in the Central Core Overlay zone. These limits would have to be increased to at least 3.0 in the High School Road District and 45 in the Mixed-Use Town Center. More modest increases in height (going from 45 to 55 feet) may also be necessary.

<sup>13</sup> Households earning 80 percent of the area median income and spending 30 percent or less of their income on housing including utilities.

<sup>14</sup> Assuming an average value of \$75,000 per development right/credit.

Ultimately, for any revisions to the current incentive program, there is a trade-off between different options that the City will need to consider. Allowing more density and heights will allow the City to require a higher share of affordable housing, lower affordability levels, and/or more dollars for purchasing TDR credits. Conversely, lower density and height maximums will result in less affordable housing and fewer dollars used for TDR purchases. However, if the defined public benefits are set too high, the private market might wait until market dynamics change for development to occur. This challenge is encountered by every jurisdiction trying to calibrate an incentive zoning policy.

## 6 Considerations and Recommendations

The City's current affordable housing incentive program and TDR program are separate incentives that compete among several other incentives and FAR purchase options available within Bainbridge Island. Neither of these programs have been utilized as originally desired. Our analysis found the current base and incentive zoning parameters are the primary barrier to the incentives working effectively.

To improve performance and the realization of public benefits, we recommend an incentive zoning framework that 1) prioritizes affordable housing and the purchase of TDR credits above other public benefits (public spaces, underground parking, etc.), and 2) maximizes the frequency and period of time that these two incentives would likely be used under a variety of changing market conditions. Broadly, there are six key changes the City can undertake to better support these two objectives.

1. **Allow a new maximum height and FAR densities.** We recommend increasing the density and height of buildings within designated growth centers. While our analysis did not identify the current height limits as barrier to the utilization of the current incentive program, we recommend increasing the current limit to allow an additional floor, so the program provides flexibility to be used under changing market conditions in the future.

We also recommend moving to an FAR-based density limit for the NC zone. The zone currently uses units per acres to define density. An FAR-based density limit would be consistent with the other growth center zones and provide more flexibility.

The table below summarizes the recommended maximum density and height limits for density bonuses by zone. Our analysis only looked at five zones with these areas. Additional analysis would be needed to determine the bonus maximums for the zones not studied.

**Exhibit 15. Recommended Maximum Bonus Density and Height Limits**

Zone	Current Bonus Density	Current Bonus Height	Recommended Bonus Density	Recommended Bonus Height
Neighborhood Center	5 unit/ac	45 feet	0.5 FAR	45 feet
Neighborhood Center/R-12	12 units/ac	45 feet	2.0 FAR	45 feet
High School Road District – 1	0.6 FAR	45 feet	3.0 FAR	45 feet
Ferry Terminal Overlay	1.1 FAR	45 feet	4.5 FAR	55-75 feet
Central Core	1.0 FAR	45 feet	4.5 FAR	55-75 feet

Source: ECONorthwest

2. **Reduce the other incentives available and focus on affordable housing and TDR.** The City currently offers incentives for several other public benefits including: providing underground parking, FAR purchases, providing on-site open space, tree preservation, historic structure preservation, etc.). Reducing competing options will prioritize the use of incentives for the affordable housing and TDR programs.

3. **Create an administrative model for the TDR program.** The current TDR program code does not identify a clear process by which a landowner or a developer can participate in the program. We recommend that the City creates both an administrative structure for the operation of the program as well as easily accessible informational resources to prospective users of the program. Until a robust market for TDR evolves in the City, we recommend a simple private buyer-seller model with public support. As program activity increases or if the City allocates funding to acquire TDR credits, the creation of a TDR bank would serve a useful purpose to augment the private market transactions. Additional resources will support the emergence of a marketplace, such as an online listing of landowners who wish to sell their development rights, electronic copies of application forms that users can download, and a dedicated webpage for the TDR program that explains the tool, identifies sending and receiving areas, illustrates the process for using the program, and gives appropriate City staff contact information.
4. **Establish a fee in-lieu option for the affordable housing and TDR incentive programs.** A fee in-lieu options would provide more flexibility for developments, particularly smaller projects. For example, as part of a revised TDR program the City could collect and use these funds for the purchase of development rights and conservation easements in Bainbridge Island.
5. **Decide to maintain a voluntary or establish a new mandatory affordable housing program.** We recommend maintaining a voluntary affordable housing incentive program. The base zoning density limits are relatively low. Thus, most future projects will likely take advantage of the affordable housing incentive if calibrated correctly. As discussed above, a voluntary program has the potential to yield more public benefits when used compared to a mandatory program as well.
6. **Establish an MFTE program.** We recommend an 8-year MFTE program. Our analysis showed that the MFTE added value for multifamily developments and it would be an additional incentive to support the viability of multifamily projects and the use of incentive programs. In addition, an 8-year program allow the City to set its own affordability requirements (both the share of affordable units and length of affordability). The 12-year MFTE program requires 20 percent of units are affordable for 12 years.
7. **Define the affordable housing and TDR benefits based on the new bonus density limits and other incentives.**
  - For affordable housing we recommend 10 percent set aside of all units built. Our analysis indicated that this share would be viable at the densities modeled. The City currently requires that all units built through the density bonus be affordable. Because the base zoning limits are relatively low, a high percent of all units are affordable, which had a sizable effect on financial feasibility.

- For TDR, the benefit to a developer is defined by an exchange rate: what additional value does a developer gain by purchasing one credit? No exchange rate is currently set by the program or code and this uncertainty deters participation. If the City is going to award density bonus on an FAR basis, the appropriate units to express an exchange rate is in additional square feet of building area per credit purchased. For example, for each TDR credit purchased, a developer may build an additional 2,000 square feet of floor area up to the FAR limit of 3.5. Further evaluation of conservation area land values is needed to calibrate an exchange rate that will drive demand for TDR.

In addition to the seven changes above, there are several small, less critical changes the City can pursue that also will help support the affordable housing and TDR incentive programs that we also recommend the City consider.

- Expand the receiving areas available for TDR credits. Residential zones, such as R-2.9 and R-3.5 could support the placement of TDR credits and conservation open space elsewhere on the island by allowing additional units in exchange for purchasing a TDR credit.
- Remove separate FAR limits for residential and commercial uses in mixed-use buildings. Instead, establish one, new FAR limit for the entire building by zone as discussed above.
- Reduce parking requirements to 1.0 space per unit. Maintain reduction of half for areas within 0.5 mile of ferry terminal, which would then allow 0.5 space per unit within 0.5 mile of ferry terminal.
- Expand the areas where denser development can be built to increase the number lower cost development sites available where projects would be financially viable. In addition to rezoning areas, this would include ensuring existing neighborhood centers have the infrastructure available to support the growth planned for those areas.

# Appendix A – Real Estate Market Analysis

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## Introduction

The City of Bainbridge Island is evaluating its inclusionary zoning and transfer of development rights (TDR) programs to understand how these programs can be better utilized to support citywide efforts for land conservation and affordable housing development. Many cities use regulatory and financial incentives to realize public benefits. However, designing and implementing incentive programs is a complex process. Primarily, real estate market conditions change over time, which make it a challenge to calibrate incentive programs. In addition, existing “base” zoning requirements, such as parking standards or height limits, may not be aligned with the incentive program, making the program less effective. Lastly, private sector participants have different needs and goals making incentive program utilization inconsistent.

ECONorthwest and Forterra are working for the City of Bainbridge Island to evaluate the City’s transfer of development rights (TDR) and inclusionary housing programs, specifically. A key first phase of this effort is understanding the current real estate market conditions, which is critical to designing an effective development incentive program. Key questions for the real estate market assessment include:

- What uses and building types are in demand?
- What building forms and intensities are likely to be built in the current market?
- How much will likely be built on an annual basis?

Understanding the answers to these questions informs the evaluation of the City’s existing incentive provisions and informs the policy options the consultant team will analyze in subsequent tasks. The remainder of this memorandum is organized into three main sections.

- **Market Analysis** considers growth and development trends for different housing types and land uses.
- **Recent Development Examples** identifies recent comparable development in Bainbridge Island and their key characteristics.
- **Real Estate Demand Outlook** assesses the market readiness of different land uses and building types and their potential to utilize development incentives.

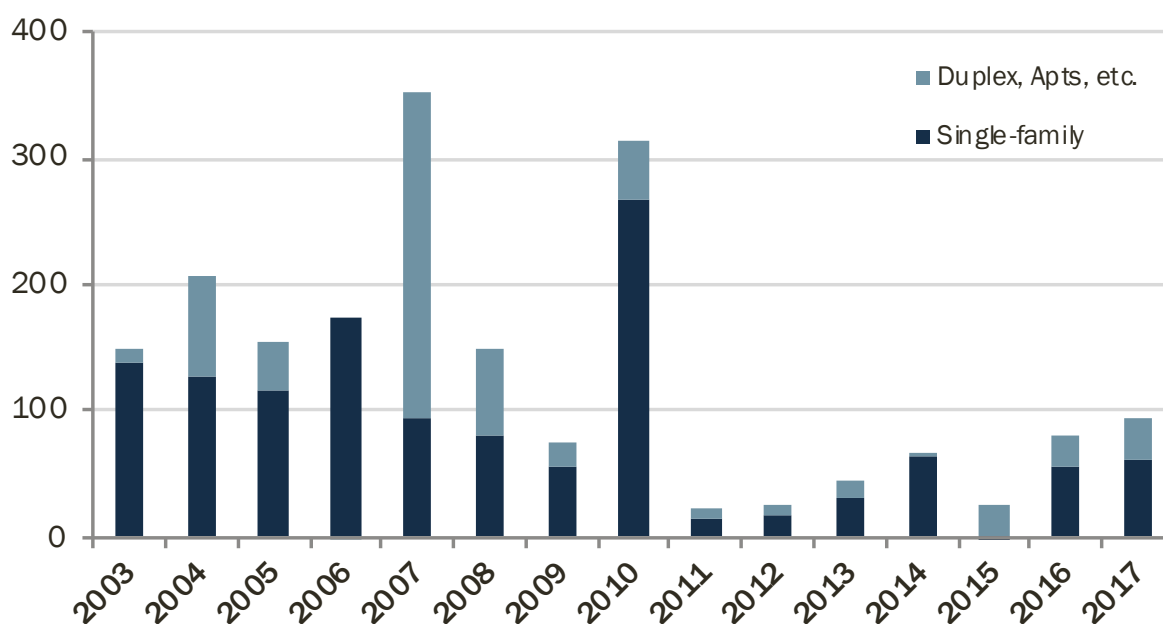
## Market Analysis

This section summarizes the changes in real estate fundamentals for housing and office uses in Bainbridge Island.

### Improving market conditions have spurred new real estate investment

Bainbridge Island has realized increasing growth and stronger market fundamentals, particularly during the last five years. The annual changes in the number of housing units built has increased over the last seven to eight years. However, the number of housing units built during the last several years is still below the pre-2008 recession averages. Since 2010, the city averaged about 50 new housing units per year. During the five years before the recession (2003-2008) the city averaged over 190 housing new units per year.

**Exhibit 16. Annual Housing Units Change for the Last 15 Years, 2003-2017**



Source: Washington Office of Financial Management, 2018

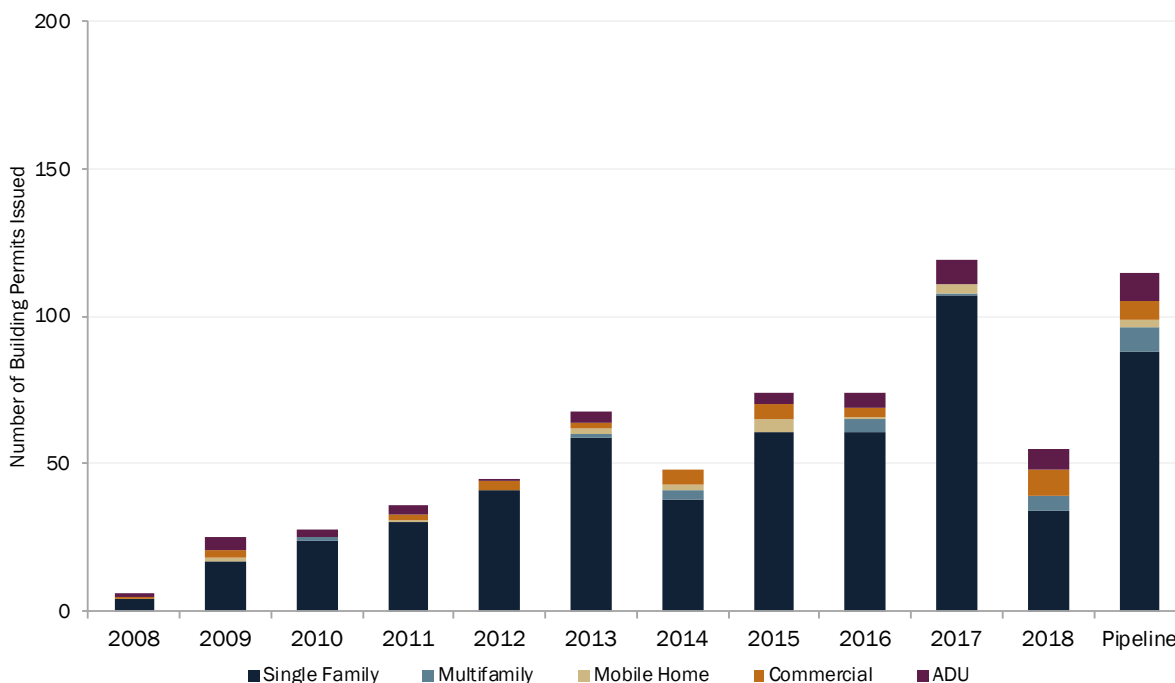
\* Note, the 2010 estimate is likely excessively large to account for underestimates in previous years and to match the 2010 Census totals.

### Building Permits Activity is Increasing

Building permit activity for new development in the City of Bainbridge has increased since 2008. During this period, the City of Bainbridge Island issued and finalized an average of approximately 58 permits annually, and 120 permits in 2017 alone. As of August 2018, the City has already issued 130 permits and finalized 55 of those permits. As a result, 2018 is likely to exceed the 2017 totals for building permits issued and finalized.

Single-family permits accounted for the greatest number of permits issued and finalized in a given year, with 75 percent of all permits issued. Exhibit 17 shows the number of permits issued for attached dwelling units, commercial, mobile homes, multifamily, and single-family units.

### Exhibit 18. Permits Issued and Finaled\* for All Uses, 2008-2018

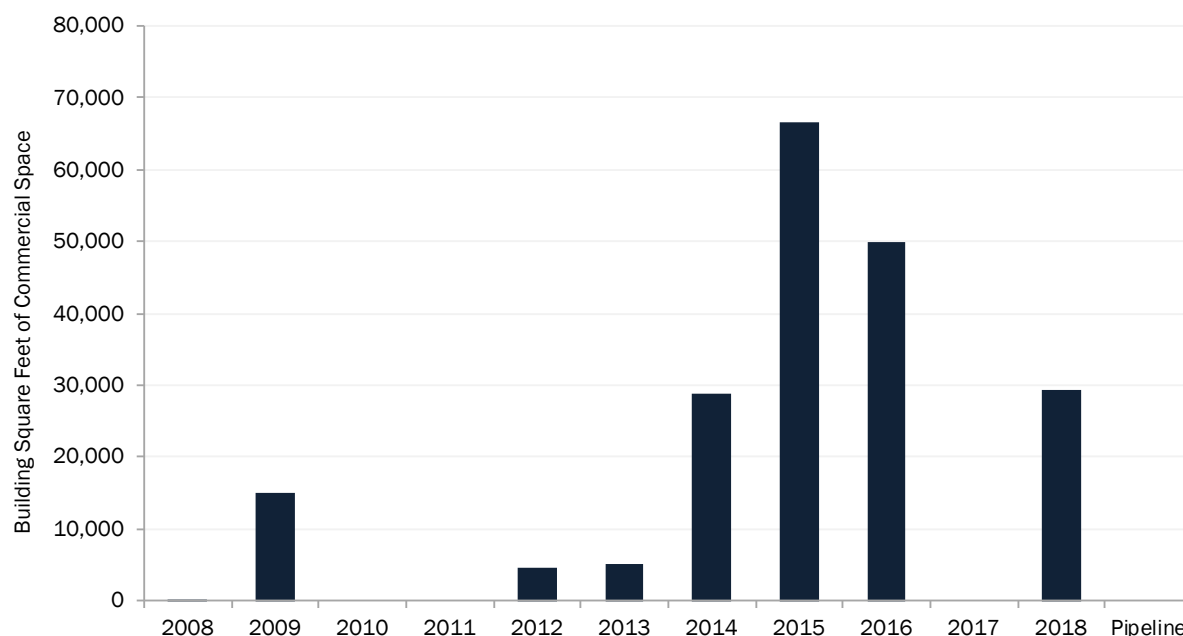


Source: City of Bainbridge Island

\*Note: Pipeline includes permits that have been issued but not finalized.

Permits for commercial development increased by over 244,000 square feet since 2008. As of August 2018, 32,732 square feet of commercial square footage has been permitted.

### Exhibit 19. Commercial Space Permitted, 2008-2018

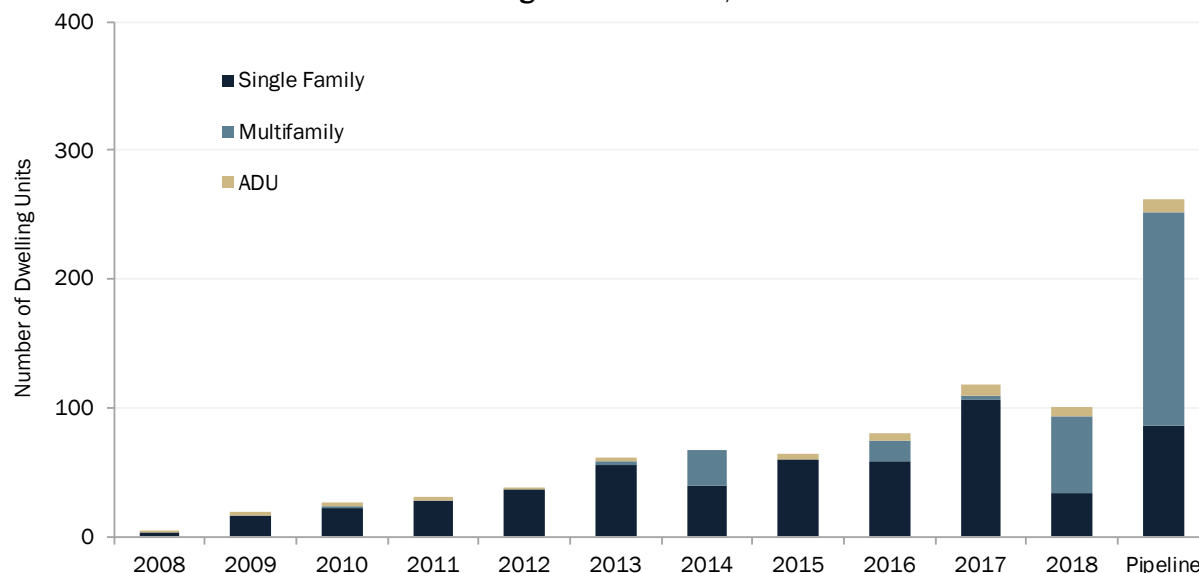


Source: City of Bainbridge Island

Exhibit 20 illustrates the trends for residential permits. Permits for single-family units steadily increased while multifamily dwelling units varied by year. In 2017, 120 housing units were

permitted. As of August 2018, 101 total units have been permitted, and 60 multifamily units have been permitted, exceeding the multifamily total for the previous ten years. Accessory dwelling units (ADUs) have remained consistent with fewer than 10 permits a year. The development pipeline (projects where permits have been issued but not finalized) is sizably larger, particularly for multifamily development, than the number of permits finalized in recent years.

**Exhibit 20. Number of Residential Dwelling Unit Permitted, 2008-2018**

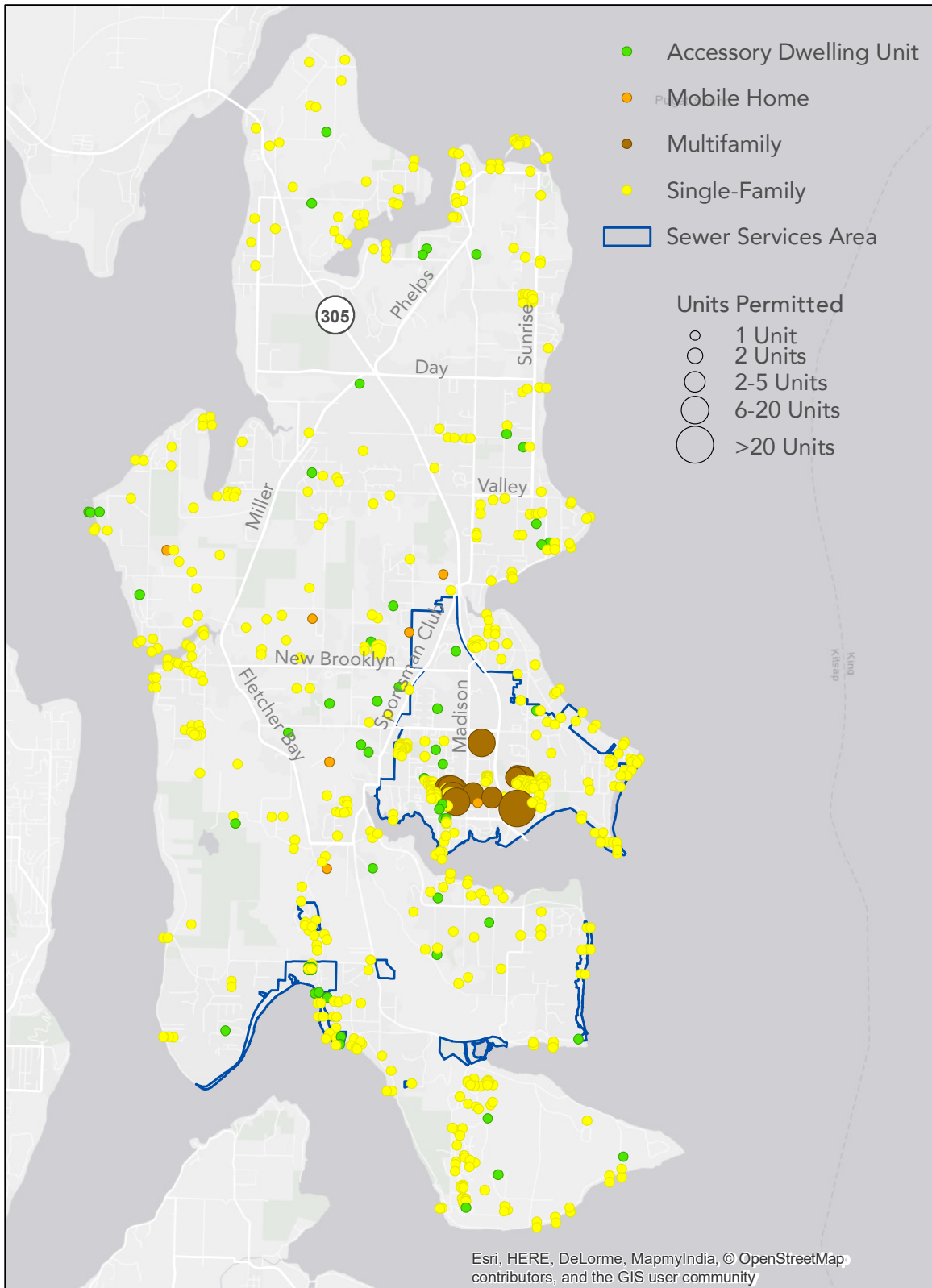


Source: City of Bainbridge Island

Note: Pipeline includes permits that have been issued but not finalized.

Exhibit 21 shows the geographic distribution of residential building permits. Permits for single-family homes and accessory dwelling units are distributed throughout the island. Multifamily permits are concentrated in Winslow where the zoning allows denser residential uses.

**Exhibit 21. Location of Building Permits by Type, 2008-2018**

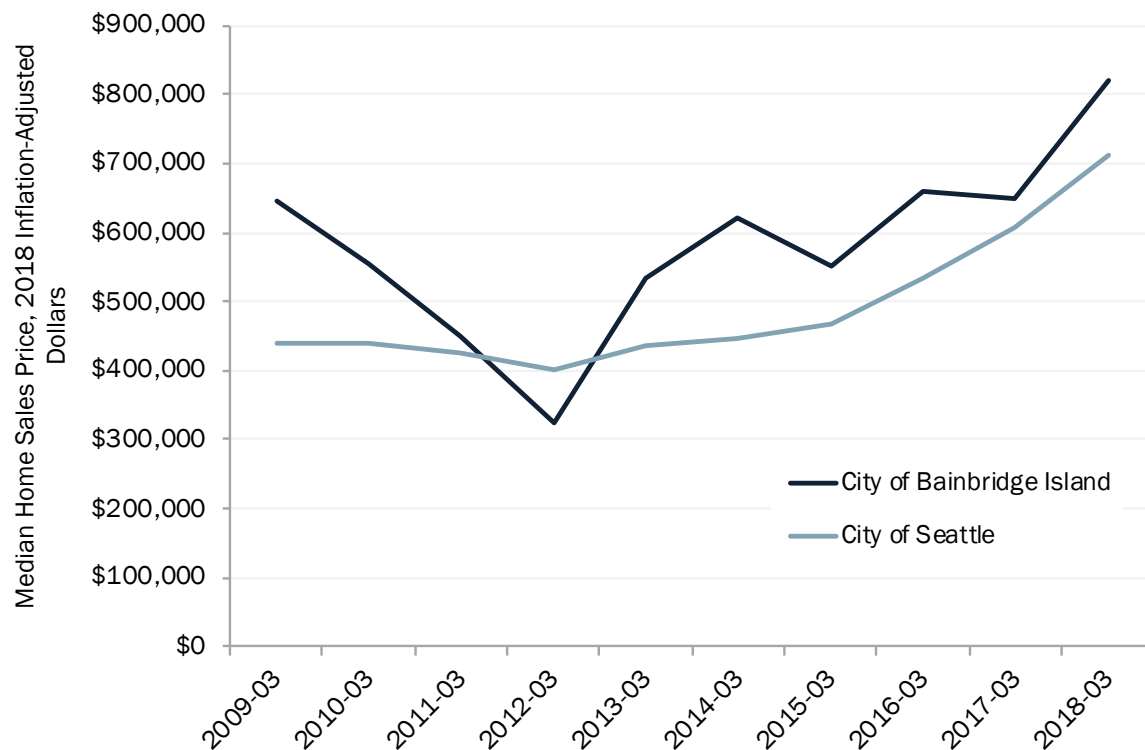


Source: City of Bainbridge Island

## Large Increase in Home Prices

In inflation-adjusted dollars, the median sales price for a home in Bainbridge Island has increased 27 percent in the last ten years, from \$719,000 in 2009 to \$820,000 in 2018. Exhibit 2 compares the changes in adjusted sales prices in the month of March of each year to median sales prices in Seattle. While the adjusted sales price in Seattle is lower, with the exception of 2012, than the annual median sales price for Bainbridge Island, the sales prices in both cities follow a similar trend.

**Exhibit 22. Adjusted Sales Prices in Bainbridge Island and Seattle MSA (2018 \$)**



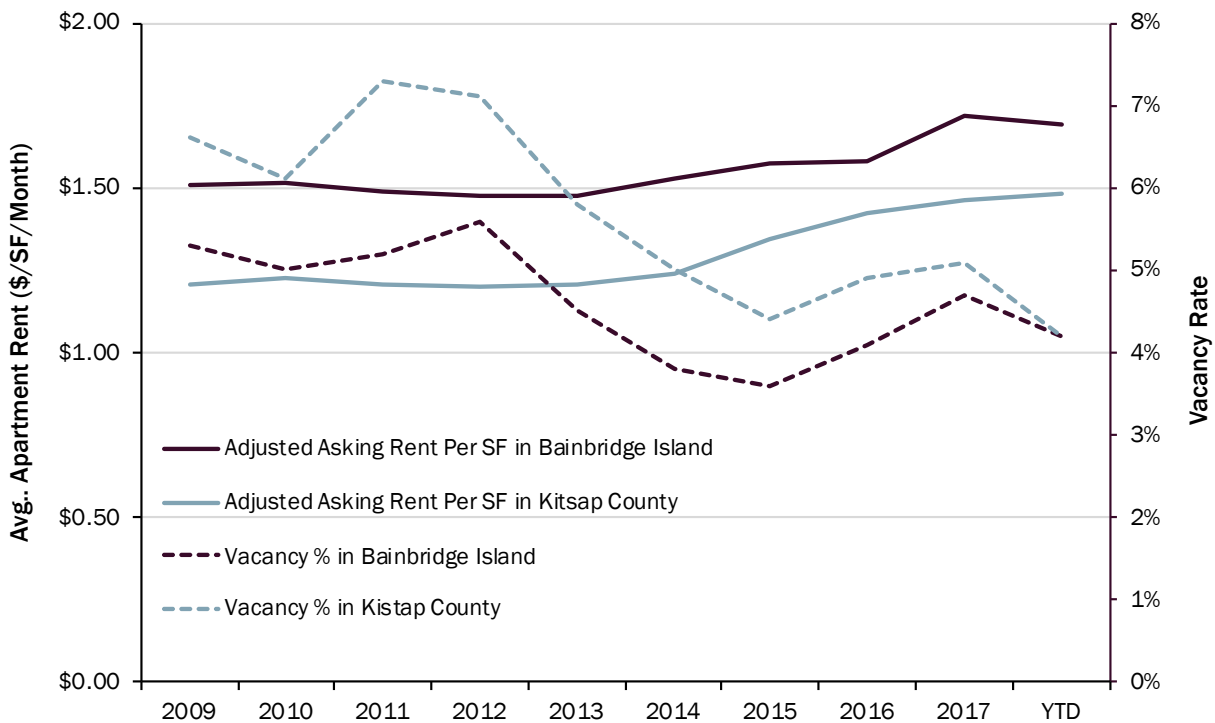
Source: Property Radar, 2018 & Zillow Research, 2018.

## Apartment Market has Strong Fundamentals

The market fundamentals for apartments indicate a tightening market as vacancies have declined and average rents have increased. In 2009, the vacancy rates for multifamily housing units in Bainbridge Island and Kitsap County were over five percent and six percent, respectively, but both decreased to 4.2 percent in 2018. As vacancy rates have declined, competition for a limited supply of housing has increased, resulting in a rise in average rents.

In Bainbridge Island, the average asking rent per square foot a month has increased from \$1.51 per square foot to \$1.69 in 2018 adjusted for inflation. This represents a 12 percent increase in average rents in the last 10 years. A \$1.69 per square foot per month rent is equivalent of \$1,690 a month for a 1,000 square foot two-bedroom apartment. Average rents in Bainbridge Island are about 15 to 20 percent higher than those in Kitsap County, overall.

**Exhibit 23. Average Apartment Rent Per SF and Vacancy, 2009 – 2018 (2018 \$)**



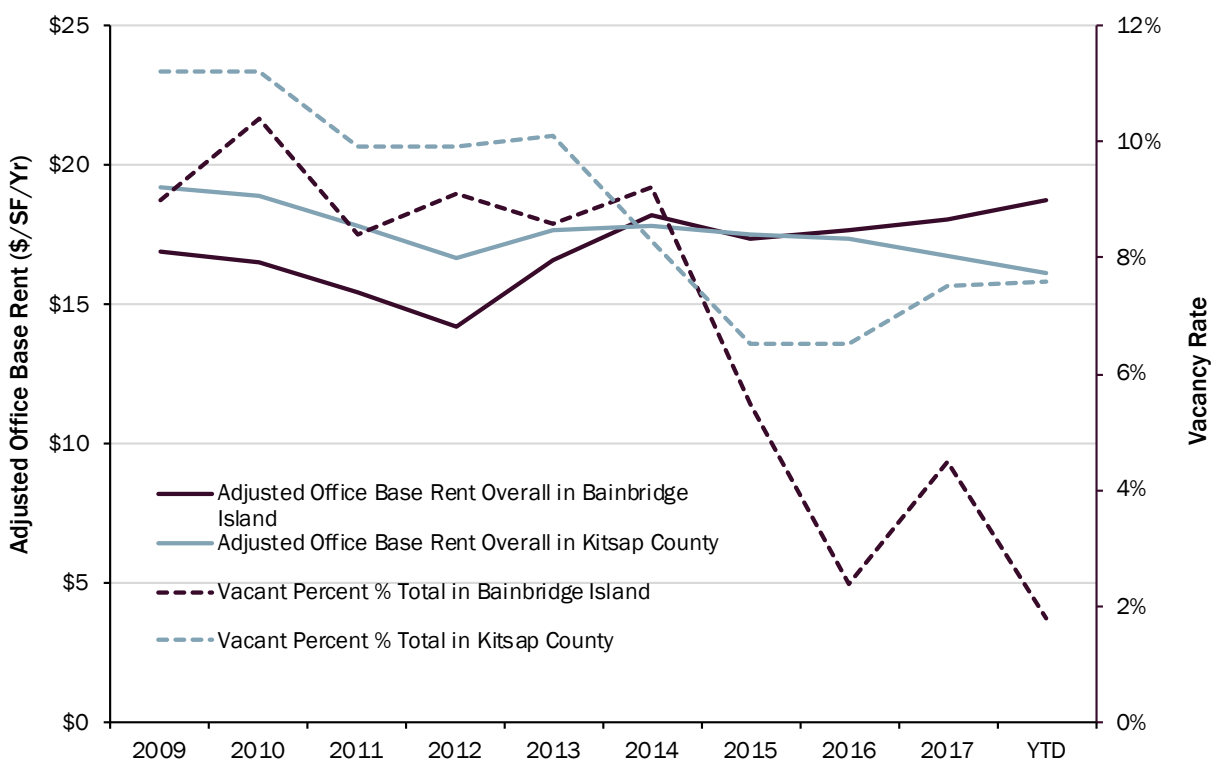
Source: CoStar, 2018

## Office Market is Improving

The office market in Bainbridge Island has also shown improving fundamentals. Most notably, the vacancy rate for office units in Bainbridge Island dropped over eight percentage points from 2009 to 2018; the current vacancy rate is less than two percent. In response, average office base rents, as shown in Exhibit 24, have increased from a low of \$14.14 per square foot per year in 2012 to \$18.70 in 2018.

While the office vacancy rate also fell for Kitsap County, office rents have also declined. As of 2018, average office rents in Kitsap County are \$16.08 per square foot, which is now less than in Bainbridge Island.

**Exhibit 24. Change in Vacancy and Adjusted Office Base Rent Overall, 2009 – 2018 (2018 \$)**



Source: CoStar, 2018.

## Recent Development Examples

Recent development projects in Bainbridge Island provide a benchmark on the scale and intensity of building the current market can support. Below are examples of projects recently built or currently under construction in Bainbridge Island.

### Office Developments

#### Bainbridge Island CrossFit

9440 Sportsman Club Rd NE, Bainbridge Island

Year Built: 2017

Stories: 2

Size: 12,000 SF

Rent: \$13.00- \$16.00 / NNN

Current Tenants: CrossFit



#### Island Gateway

204 Ravine Ln NE, Bainbridge Island

Year Built: 2010

Stories: 3

Size: 37,626 SF

Rent: \$20.00 – 24.00 / SF

Vacancy Rate: 0%

Current Tentants: NA



## Multifamily Developments

### Bainbridge Landing

259 Ferncliff Ave., Bainbridge Island

Year Built: Under construction (delivers April 2019)

Units: 107

Stories: 4 | Buildings: 8

Parking: Ground-level and surface parking

Total Floor Area: 100,000 SF

Average Unit Size: 763 SF

Unit Mix: 70% (1-Bed)

30% (2-Bed)



### Grow Community – Condos (The Tsuga)

221 Wyatt Way NE, Bainbridge Island

Year Built: 2015

Units: 15

Stories: 3 | Buildings: 1

Rent: NA

Total Floor Area: 21,174 SF

Parking: Ground-level and Surface Parking

Average Unit Size: 1,412 SF

Unit Mix: 100% (1-Bed)



## Single Family Developments

### Grow Community - Townhomes

Ambrose Lane NW, Bainbridge Island

Year Built: 2013

Square Feet: 1,500 – 1,800

Sales Price: \$600,000 - \$800,000



### Winslow Grove

NE Winslow Grove Court, Bainbridge Island

Year Built: 2018

Square Feet: 3,000 – 4,200

Sales Price: + \$1.1 million



These project examples indicate:

- Office and commercial developments are likely to be modest in size (both height and total area).
- Current apartment rents and sales prices can support multi-story buildings with a mixture of ground-level and surface parking.
- A variety of single-family home types are in demand from larger single-family homes to smaller, more compact options, such as townhomes.

## Demand Outlook

The real estate market trends and recent development examples point to a city that is seeing an increase in demand, primarily for housing development of all types. This uptick in demand has occurred relatively recently. For much of the 2010's the city did not realize much new development following the effects of the recession in 2008. As a result, housing supply has been lagging housing demand and rents and sales prices have been increasing, particularly the over the last five years.

A continuation of these growth trends and historically low vacancies indicate there will likely be demand for more housing (single-family and multifamily) in the future. The resulting increase in population will also drive the demand for additional commercial space to provide goods and services.

### Outlook by Use

- **Single-Family Outlook.** Demand for single-family homes in Bainbridge Island is likely to continue. The city has a high quality of life and has direct access to downtown Seattle. As the region continues to grow and home prices in Seattle increase, Bainbridge Island will potentially see even greater demand.

As land values increase in Bainbridge Island, the market for single-family homes will increasingly be for both smaller housing forms (such as townhomes and small-lot homes) and larger, higher-end homes to justify the higher cost of land.

- **Multifamily Outlook.** Low vacancies and increasing rents indicate increasing demand for apartments as well. Recent multifamily developments are three- to four-stories with parking integrated into the ground level. As land values increase, taller apartment or mixed use buildings will likely be viable.
- **Office Outlook.** The office market in Bainbridge Island has also shown improving fundamentals. Office vacancies have decreased sizably from over ten percent in 2010 to less than two percent in 2018. In response, office rents in Bainbridge Island have increased at a rate of 2.1 percent a year to \$18.70 per square foot per year by 2018. Future office development will likely not be a primary driver of growth, and it is also likely to be oriented to smaller office users. As a result, future projects will likely continue to be small in scale.

## Implications for Development Incentives

For a development incentive program to be effective it needs to align with where development is occurring, the uses that are demanded, and the intensity of that development. The real estate market conditions in Bainbridge Island indicate there is an opportunity for the utilization of development incentives.

### Winslow has the most potential for future development

Winslow has realized much of the new growth in Bainbridge Island, which aligns with the City's comprehensive plan. Winslow has the infrastructure, specifically water and sewer service, to accommodate future growth. Winslow is also an attractive location for development because of the proximity to the ferry terminal.

### Neighborhood Centers have Limited Potential Due to a Lack of Infrastructure

In the comprehensive plan, neighborhood centers are designated for more intense development. With the exception of Lynwood Center, a lack of infrastructure (primarily water and sewer service) limit the development potential of these areas. The capacity and use of development incentives within these areas will be tied to the provision of the necessary infrastructure.

### Residential uses have the best opportunity for utilizing development incentives

Most of the recent development and permit activity in Bainbridge Island is for single-family housing. More recently, multifamily housing, particularly in Winslow, is also realizing sizable new developments. As a result, development incentives should focus on leveraging demand for these uses.

### Residential projects will want to maximize density

Future projects may be looking to increase densities (i.e. smaller lots and more units per acre for single-family homes and more height and building area for multifamily projects). This demand can be leveraged to support both the purchase of development rights and the creation of affordable housing as part of a City's development incentive programs.

## Appendix B – Pro Forma Assumptions

Construction Cost		
Podium Lobby/Amenities	\$ Per SF	\$125.00
Podium Commercial	\$ Per SF (including TI)	\$240.00
Residential Stick	\$ Per SF	\$180.00
Surface Parking Space	\$ Per space	\$5,500.00
Podium Parking Space	\$ Per space	\$30,000.00
Underground Parking Space	\$ Per space	\$60,000.00
Surface Parking	\$ Per SF	\$16.92
Podium Parking	\$ Per SF	\$72.29
Underground Parking	\$ Per SF	\$144.58
Open Space	\$ Per SF	\$5.00
Site Prep	\$ Per SF	\$2.00
Soft Costs	% of Hard Cost	25.00%
Contingency	% of Hard and Soft Costs	5.00%
Developer Fee	% of Total Cost	3.50%
Land Value	\$ Per SF	\$25.00
TDR Purchase	Total \$	\$75,000.00
Sales Costs Incl. Commission	% of Sales Price	6.0%

Income		
Residential Rent	per Month	\$2.50
Residential Rent Affordable	per Month	\$1.75
Residential Sales Price	Per SF with 5% sales commission	\$450.00
Residential Sale Price Affordable	Per SF with 5% sales commission	\$150.00
Retail Rent	NNN per Year	\$25.00
Parking Rent	per Month	\$0.00
Residential Vacancy	% of Revenue	5.00%
Retail Vacancy	% of Revenue	0.00%
Residential Operating Cost	% of Rent	20%
Retail Operating Cost	% of Rent	35%
Prop Tax Rate	per \$1,000 Residential AV	\$7.44

Return	
Rental Return on Cost	5.50%
For-sale Return on Cost	20.00%

# Appendix C – Median Income Limits



## CITY OF BAINBRIDGE ISLAND 2018 MEDIAN INCOME LIMITS BY HOUSEHOLD SIZE BREMERTON-SILVERDALE MSA (HUD)

Maximum Income Limits by Category (BIMC 18.21.020)	Household Size							
	1	2	3	4	5	6	7	8
<b>Extremely Low Income: ≤ 30% of Median Household Income</b>	\$17,400	\$19,850	\$22,350	\$24,800	\$26,800	\$30,800	\$32,750	\$32,750
<b>Very Low Income: 31% - 50% of Median Household Income</b>	\$28,950	\$33,050	\$37,200	\$41,300	\$44,650	\$47,950	\$51,250	\$54,550
<b>Low Income: 51% - 80% of Median Household Income</b>	\$46,300	\$52,900	\$59,500	\$66,100	\$71,400	\$76,700	\$82,000	\$87,300
<b>Moderate Income: 81% - 95% of Median Household Income</b>	\$54,929	\$62,776	\$70,623	\$78,470	\$84,748	\$91,025	\$97,303	\$103,580
<b>Middle Income: 96% - 120% of Median Household Income</b>	\$69,384	\$79,296	\$89,208	\$99,120	\$107,050	\$114,979	\$122,909	\$130,838
<b>100% of Median Household Income</b>	\$57,820	\$66,080	\$74,340	\$82,600	\$89,208	\$95,816	\$102,424	\$109,032